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No. 06-06-837

IN THE

Supreme Court of the United States

OLD STONE CORPORATION,
Petitioner,

v.

UNITED STATES,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Federal Circuit incorrectly held that the victim of a total contract breach, by making post-breach mitigation efforts, made an "election of remedies" that forfeited its remedy of restitution, where it did not receive, and could not expect to receive, any post-breach contract performance from the breaching party.

2. Whether the Federal Circuit incorrectly barred restitution on the ground that restitution would make the victim better off than if the contract had been performed.

RULE 29.6 STATEMENT

Petitioner Old Stone Corporation has no parent corporations, and no publicly held company holds 10% or more of its stock. *See* S. Ct. Rule 29.6.

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PETITION FOR A WRIT OF CERTIORARI

Old Stone Corporation ("Old Stone") respectfully petitions this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The Federal Circuit's opinion (App. 1a-28a) is reported at 450 F.3d 1360. The damages opinion of the Court of Federal Claims (App. 29a-98a) is reported at 63 Fed. Cl. 65. The liability opinion of the Court of Federal Claims (App. 99a-106a) is unreported.

JURISDICTION

The corrected judgment of the court of appeals was entered on May 25, 2006. App. 1a. A timely petition for panel and en banc rehearing was denied on September 21, 2006. App. 107a-08a. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATEMENT

It has long been recognized that a total breach of a contract entitles the victim to restitution of amounts invested under the contract. In this case, however, the Federal Circuit sharply curtailed the availability of that traditional remedy by relying on two novel, and insupportable, theories. First, it expanded the "election of remedies" bar to restitution, holding that it applies even where the victim did not accept and could not expect any post-breach contract performance from the breaching party, but simply engaged in reasonable post-breach mitigation efforts. Second, invoking a flawed concept of "windfall," it rejected restitution on the ground (contrary to the trial court's factual finding) that it would make the victim better off than if there had been no *breach*, though the award merely returned the victim the money it would have retained had there been no *contract*. Both rulings conflict with *Mobil*

Oil Exploration & Producing Southeast, Inc. v. United States, 530 U.S. 604 (2000), and with the established law of contracts recognized in various lower court decisions, and together they threaten serious harm. The Court should review and reverse the decision.

A. Background

The case involves two transactions – similar to those which gave rise to this Court's decision in *United States v. Winstar Corp.*, 518 U.S. 839 (1996) – in which Old Stone came to the aid of the Government in reliance on key Government promises. In both transactions, dated 1984 (Rhode Island Federal, or RIF) and 1985 (Citizens Federal), Old Stone, at the request of and under contract with the Government, committed cash and stock (in a financially sound institution) to rescuing two savings and loan associations (thrifts) that were at risk of failure – for which the Government would have borne financial responsibility. As relevant here, the value of the stock and cash taken from a safe investment and committed to the risky thrifts at the Government's behest was $118 million ($103.2 million for RIF; $14.8 million for Citizens). App. 2a, 3a, 8a; App. 58a n.23 (value of stock part of investment undisputed), 72a (Old Stone contributions required under contracts).

Under the transactions, the acquired thrifts became part of an integrated, federally regulated and insured thrift – Old Stone Bank (OSB). App. 2a-4a. In both transactions, the Government made formal promises that Old Stone Bank could count certain supervisory goodwill and capital credits toward meeting the federally set capital requirements. *Id.* Old Stone rejected the Government's solicitations for its involvement until it received these and other promises. App. 29a, 35a. The Government, as insurer, received the benefit of acquisitions like Old Stone's: the "merger incentives were part of a regulatory scheme" designed "to sustain the savings and loan industry and to avoid exhaustion of the FSLIC

[Federal Savings and Loan Insurance Corporation] insurance fund." App. 35a; *see* App. 38a (Government approved first transaction "'to prevent the probable failure' of a federal institution"); 67a (Government approved second transaction because "it cost less than liquidation").

By 1989, the Government's obligations under its contracts with Old Stone had by their terms come to an end, with just one exception. App. 11a (Citizens: December 1987); PX135 § 12, at 23-24 (RIF: October 1986). The sole remaining Government performance obligation was to fulfill – for 25 years (Citizens) or 30 years (RIF) – its crucial promises regarding how OSB could count capital for regulatory purposes. App. 3a-4a. In 1989, however, the Government breached that obligation by enacting the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), which sharply restricted what capital counted for regulatory purposes. *Winstar*, 518 U.S. 839; App. 4a-5a, 39a.

Old Stone Bank, having suddenly "lost $80 million in capital as a result of Congress' enactment of FIRREA" (App. 40a; *see* App. 9a), was "'undercapitalized' and subject to seizure" under the new rules. App. 5a, 79a. The Government, exercising its "regulatory authority" (App. 79a), immediately demanded that Old Stone infuse ("downstream") new capital into Old Stone Bank. App. 40a n.9 (regulators "backed up such directives with the threat of cease and desist orders and civil penalties"; "regulators gave it no choice"); 41a-42a ("The Office of Thrift Supervision required Old Stone to prepare a Capital Plan" and "conditioned" its approval on Old Stone's "agreement that it would maintain the bank's capital position pursuant to the Net Worth Maintenance Stipulation" by infusing new funds into the bank); 64a (rejecting Government's contention that Old Stone acted voluntarily in infusing

funds post-breach).[1] In finding Old Stone's mitigation efforts reasonable, the trial court noted that the Government "required those very efforts," backing the requirements with "'very, very large civil penalties' . . . for those who did not cooperate." App. 83a; *see* App. 66a & n.28 (post-breach infusions "apparently under some duress"). The Government later told the Federal Circuit: "[t]he requirement to make the capital contributions was a regulatory requirement . . . ." U.S. Ct. App. Br. 39.

In response to the Government's demands, Old Stone invested $74.5 million to meet the new capital requirements and otherwise undertook mitigation efforts to try to avoid a bank failure that would, if it occurred, leave the Government, as insurer, holding the bag. App. 6a. To do so, Old Stone sold prized profitable assets at sacrificial prices. *Id.* ("'crown jewels'" sold "to fund these downstream payments"); App. 44a; *see* App. 42-46a. Old Stone's efforts almost succeeded: by the end of 1992, Old Stone Bank was "profitable on an operating basis." App. 76a; *id.* (quoting regulatory assessment that "'core earnings power is being restored'"). But in January 1993, the Government seized Old Stone Bank. App. 7a.

Old Stone sued for breach of contract in the Court of Federal Claims in 1992, even before the seizure. App. 30a. It sought recovery of both its post-breach $74.5 million infusion and its original $118 million investment. Both the trial court and the Federal Circuit approved return of the $74.5 million payment, finding it a reasonable mitigation expenditure on Old Stone's part. But the Federal Circuit, reversing the trial

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[1] In Old Stone's Net Worth Maintenance Stipulation (NWMS) in the RIF transaction, Old Stone promised to add capital to the bank as needed to comply with certain regulations except to the extent that the Government "has agreed to forbear from enforcement" of such regulations. PX135, attachment.

court, rejected return of the original $118 million investment as restitution. That rejection of restitution is at issue here.

B. Trial Court Proceedings

The Court of Federal Claims, after a long delay caused by consolidated discovery proceedings in numerous *Winstar* cases, first granted summary judgment on liability against the Government. App. 99a-106a. The case then proceeded to trial on damages. Based on the trial, the court awarded Old Stone both its post-breach infusion of $74.5 million, as damages for reasonable mitigation efforts, and its original investment of $118 million, as restitution and (alternatively) as reliance damages. App. 96a-98a; *see* App. 29a-98a.

The court made a number of findings beyond those already noted. It found that Old Stone "made every reasonable effort to mitigate its damages after the breach." App. 57a; App. 78a (regulators praised mitigation efforts). In its effort to meet the post-1989 capital requirements, Old Stone shrunk the bank's assets from $3.4 billion at its peak to $1.8 billion. App. 68a. Although "factors other than the breach affected the bank's operations" after the breach, the court found that "it would have survived with the benefit of the capital cushion provided by the regulatory capital for which it contracted," App. 76a, and the Government "did not show that the losses would have occurred" without the breach. App. 78a; *see* App. 75a-76a. The court also found that the breach was "total." App. 89a-91a, 96a. The court further found that, while a restitutionary award *can* be offset by benefits received by the breach victim, in this case the Government "did not submit sufficient evidence for us to value" any such offsetting benefits. App. 90a; *see* App. 92a-93a.

The court specifically ruled that Old Stone had not forfeited its right to restitution by its post-breach actions, including its $74.5 million infusion "under pressure from the regulators." App. 91a. The court observed: "For [Old Stone]

to waive its right to restitution by attempting to save the bank, and to save the Government money in the process, would be an ironic result." App. 91a. The court also found that the Government had not proved that Old Stone received benefits from its post-breach conduct. App. 92a.

Finally, the trial court found that restitution would not provide a windfall to Old Stone, even compared to a hypothesized contract performance. "We heard no credible evidence that returning [Old Stone's] investment would place it in a better position than it would have been [in] had the Government not breached its contract." App. 94a.

C. The Court of Appeals Decision

The court of appeals affirmed the award of the $74.5 million for the post-breach investments as mitigation damages (App. 9a-14a), but it reversed the award of the $118 million for the original investment (App. 14a-27a). As to the former, the court explained that a breach victim "may generally recover its mitigation costs incurred in a *reasonable* effort to avoid loss caused by a breach, even if its efforts prove unsuccessful." App. 9a (emphasis added) (citing *Restatement (Second) of Contracts* §§ 347, 350 (1979) ["*Restatement*"]); *id.* at 13a (stressing reasonableness requirement). Here, the court held, because Old Stone "was entitled to replace the entire amount of regulatory capital eliminated by FIRREA so that the thrift had a cushion against future losses," Old Stone's "mitigation efforts were reasonable under the circumstances." App. 14a.

The court reversed the award returning Old Stone's original $118 million investment, holding in particular that the award of restitution was improper as a matter of law.[2] In so

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[2] The court also rejected the award as reliance damages. App. 21a-27a. In so holding, it concluded, contrary to the trial court, that, once the FIRREA-destroyed regulatory capital was replaced by Old Stone, "the

holding, the court did not question that FIRREA was sufficiently grave a breach to trigger restitution or that restitution generally would return the contract-required original investments, which had benefitted the Government. App. 14a-15a. But it rejected restitution based on an "election of remedies" analysis and a (brief) "windfall" conclusion.

The court began by stating its understanding of the election-of-remedies doctrine: "[w]hen a non-breaching party elects to continue performance [after a breach], that party is said to elect to treat the breach as partial rather than total" and "restitution is not available," with the victim relegated instead to seeking only damages for partial breach. App. 15a-16a. The court discussed several authorities for that principle, including this Court's decision in *Mobil Oil*.[3] The court stated that there was uncertainty about whether election can rest on the victim's "mere continued performance" post-breach or also requires that the post-breach conduct cause detrimental reliance by the breaching party or confer a benefit on the victim. App. 17a-18a. Having framed its view of the law that way – without focusing on *contract performance from the breaching party* as the threshold requirement for election – the Federal Circuit held that Old Stone's post-breach conduct effected an election under both of the two views of the law it stated. App. 18a.

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loss of [Old Stone's] initial contributions w[as] not a foreseeable result of the enactment of FIRREA." App. 27a.

[3] The court relied on *Restatement (Second) of Contracts* § 378; 13 *Williston on Contracts* § 39:32, at 642-46 (4th ed. 2000); 12 *Corbin on Contracts* § 1223; J. Perillo, *Calamari & Perillo on Contracts* §§ 11.32-11.33 (5th ed. 2003). It also relied on three decisions, the first two involving a related "waiver" issue: *Barron Bancshares, Inc. v. United States*, 366 F.3d 1360, 1383 (Fed. Cir. 2004); *Northern Helex Co. v. United States*, 455 F.2d 546, 551 (Ct. Cl. 1972); *Cities Service Helex, Inc. v. United States*, 543 F.2d 1306, 1315-16 (Ct. Cl. 1976).

The court identified the continued performance by Old Stone as its post-breach infusion of additional capital ($74.5 million) to meet the regulators' demands. App. 18a. The court next ruled that the Government "detrimentally relied on [Old Stone's] conduct": it stated that if Old Stone had "elected to terminate the contract" immediately after FIRREA, the Government "could not have, and would not have, demanded" the $74.5 million post-breach infusion and would have seized Old Stone Bank earlier than 1993, when the "risk-based capital shortfall" was higher than in 1989. App. 19a & n.11. Critically, however, the court did not (and could not) say that any Government reliance constituted *Government contract performance*; indeed, the court accepted that the Government had no contract performance left to make (except to honor its 25-30-year promises about regulatory capital, which FIRREA breached). Even as to the identified reliance, moreover, the court did not explain how the Government was harmed by Old Stone's making of the $74.5 million contribution that the Government had demanded (which became part of the assets of the bank the Government seized) or why an increased shortfall in "risk-based capital" (a regulatory concept) measured an increase in Government liability upon seizure.

The court also concluded that Old Stone benefitted from the delayed seizure. The benefits, the court said, were

> its ability to continue to operate the thrift; the government's willingness to defer enforcement of the obligation of [Old Stone] to contribute additional capital pursuant to the [Net Worth Maintenance Stipulation] under the earlier agreements; the non-seizure of the thrift before 1993 (despite its non-compliance with FIRREA standards); and continued federal deposit insurance.

App. 19a (footnote omitted). Again, the court did not and could not say that any of these benefits were the receipt by

Old Stone of Government performance under the *breached contracts*.

Finally, the court briefly stated its policy rationale for its election-of-remedies ruling, citing the "moral hazard that would result here if the thrift could postpone repudiation of the contract for several years, bet that it could make the thrift profitable, but secure restitution if the thrift failed." App. 19a-20a. It quoted its predecessor court's statement that a breach victim "'cannot continue after a material breach by the other[,] . . . act as if the contract remains fully in force. . ., run up damages, and then go suddenly to court.'" App. 20a (quoting *Northern Helex*, 455 F.2d at 551). The court did not say how mitigation efforts without acceptance, or even an expectation, of *contract* performance from the breaching party can constitute "act[ing] as if the contract remains fully in force" or how a victim can "run up damages" when post-breach expenditures in mitigation are recoverable only if reasonable.[4]

Having rejected restitution based on election of remedies, the court stated one additional reason for rejecting restitution, as a matter of law, in the last substantive paragraph of its opinion. App. 27a. It stated that restitution is "inappropriate where relief would result in an 'unfair windfall' to the non-breaching party," and it quoted a statement that "'the non-breaching party should not be placed in a better position through the award of damages than if there had been no breach.'" App. 27a.[5] The court then declared that awarding

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[4] The court ended its election discussion by concluding that the result was not altered by certain contract provisions, which state that the "rights, powers, and remedies given to the parties by this Agreement shall be in addition to" others given by law and "[a]ny forbearance, failure, or delay" in "exercising or partially exercising any such right, power, or remedy shall not preclude its further exercise." App. 20a.

[5] The Federal Circuit had never before applied this principle to restrict a restitution award. The Federal Circuit quoted *Bluebonnet Sav. Bank,*

anything more than return of the post-breach $74.5 million infusion "would be duplicative" (*id.*) – without explaining how duplication would be present in returning two separate investments, the original $118 million as well as the $74.5 post-breach investment.

REASONS FOR GRANTING THE PETITION

Just six years ago, this Court in *Mobil Oil* reiterated that companies contracting with the Government are entitled to restitution under certain circumstances, explaining: "If the Government said it would break, or did break, an important contractual promise, . . . then (unless the companies waived their rights to restitution) the Government must give the companies their money back[, a]nd it must do so whether the contracts would, or would not, ultimately have proved financially beneficial to the companies." 530 U.S. at 608. In the present case, however, although the Federal Circuit accepted that FIRREA breached an important contractual promise (was a total breach) and that restitution would return to Old Stone its original investment, the court nonetheless denied Old Stone restitution by fashioning two dramatically new limits on that fundamental remedy. First, the Federal Circuit expanded the "election of remedies" bar to claiming restitution, holding that a breach victim, by taking the normal step of making mitigation efforts to reduce the resulting harm, thereby surrenders restitution of its contract-required investment even though it has not accepted (and cannot expect) any

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FSB v. United States, 339 F.3d 1341, 1345 (Fed. Cir. 2003), which did not involve a restitution award, and *LaSalle Talman Bank, FSB v. United States*, 317 F.3d 1363, 1376-77 (Fed. Cir. 2003), which said (for other reasons) that restitution was not a proper measure of damages in that case. In *Hansen Bancorp, Inc. v. United States*, 367 F.3d 1297, 1313-14 (Fed. Cir. 2004), which first stated the principle where restitution was at issue, the Federal Circuit acknowledged that how to calculate damages was not yet before it, because an adjudication was still needed on whether a total breach had occurred and hence whether restitution was available at all.

post-breach contract performance from the breaching party. Second, the Federal Circuit held that restitution is barred as a "windfall" if it would make the victim better off than *if there had been no breach*, though not better off than *if there had been no contract.*

These alterations of restitution law warrant review for a number of reasons. To begin with, both rulings squarely conflict with this Court's decision in *Mobil Oil*, which specifically rejected the Government's attempts to invoke both grounds in order to escape the remedy of returning investments upon total breach. 530 U.S. at 621-23 (election); *id.* at 608, 623-24 (windfall). The Federal Circuit, expressing uncertainty about *Mobil Oil* (App. 17a-18a), misread the decision and thus effectively rewrote it by limiting restitution in ways that cannot be reconciled with this Court's express reasoning and holding.

Moreover, the decision below is contrary to basic contract-law principles that have been recognized and applied in various lower court decisions both outside and within the Federal Circuit. The conflicting decisions are not only contract-law cases generally, which is an important enough conflict, but in *Winstar* cases specifically, involving restitution for the Government's breach of its promises to those who came to its rescue when federally insured thrifts were at risk. The Federal Circuit has stripped investors in those thrifts of a restitution remedy that it and other circuit courts had held to be available, upsetting the earlier decisions' recognition that post-breach mitigation efforts do *not* forfeit restitution and that restitution returns the victim to pre-*contract* status, not a hypothesized post-*performance* status.

The decision below – by the appellate court with unique authority over federal contract law – threatens to work significant harm to the large community of government contractors and, ultimately, to the Government itself. Most specifically, by basing a loss of restitution on post-breach mitigation

efforts, the Federal Circuit has powerfully deterred efforts by breach victims to mitigate the harm caused by a breach – efforts that can benefit not only the breach victim but the breaching party as well, especially when the breaching party is the Government, which stands to be liable as insurer if mitigation efforts fail. More generally, the stripping of a basic contract remedy is not just unfair to contracting parties but will raise the cost of contracting, making it more difficult and more costly for the Government to find contract partners when it needs them. This Court should grant review in this case and reverse the new limits on traditional restitutionary contract remedies.

A. The "Election of Remedies" Ruling – That a Breach Victim Forfeits Restitution By Making Post-Breach Mitigation Efforts, Where the Victim Does Not Accept (and Cannot Expect) Further Contract Performance from the Breaching Party – Conflicts with This Court's Decision in *Mobil Oil* and the Basic Law of Contract Remedies Recognized in Other Decisions

The Federal Circuit made its first error by holding that Old Stone forfeited its right to restitution of its initial investment. Although the court did not question that the basic preconditions for restitution were present,[6] it held that Old Stone "elected" to forego restitution because Old Stone engaged in post-breach mitigation efforts, even though Old Stone did not receive, and could not expect to receive, any post-breach *contract* performance from the breaching party. (By the time

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[6] Old Stone's $118 million original investment saved the Government from having to take over the unsound thrifts for which Old Stone instead took responsibility. *See, e.g., Glendale Fed. Bank, FSB v. United States*, 378 F.3d 1308, 1313 (Fed. Cir. 2004) (allowing "restitution for the limited purpose of returning the acquiring thrift to the status quo ante when specific initial contributions to an acquired thrift have been established"); *Landmark Land Co. v. FDIC*, 256 F.3d 1365, 1373-74 (Fed. Cir. 2001).

of the breach, the contracts had already been terminated, except for the Government's obligation to continue recognizing the promised regulatory capital for 25-30 years – an obligation that the Government could no longer honor.) In expanding "election of remedies" to apply in such circumstances, the Federal Circuit made new and incorrect law. The decision warrants review for multiple reasons.

1. The Federal Circuit's ruling is directly contrary to this Court's decision in *Mobil Oil*. The Federal Circuit, finding *Mobil Oil* unclear (App. 17a-18a), simply misread the decision. It thus announced new grounds for forfeiture of restitution that ignore the essential precondition recognized in *Mobil Oil*. This Court should provide the clarification needed to restore the threshold requirement the Federal Circuit here overlooked.

In *Mobil Oil*, this Court made clear that there can be no election forfeiting the right to restitution where the breach victim does not receive further *performance of the breached contract* from the breaching party, let alone where the victim cannot expect any such performance (as here). Proceeding in two steps, the Court first held that the Government had committed a "total breach" through repudiating its contract and that the plaintiffs were, as a result, entitled to restitution of the money they paid for the rights to explore for oil and gas – unless they had waived that entitlement. 530 U.S. at 607-21; *see id.* at 614 ("relevant contract law entitles a contracting party to restitution if the other party 'substantially' breached a contract or communicated its intent to do so"). The Court then rejected the Government's argument that the plaintiffs had waived restitution, relying on *Restatement* § 373 cmt. *a*, which points to § 378 on "election." *Mobil Oil*, 530 U.S. at 621-23.

The rationale for that rejection, which the Court expressed both in stating and in applying the rule, precludes the Federal Circuit's result here. This Court reasoned that the plaintiffs'

own "continued actions under the contracts" were insufficient to forfeit restitution, because they could not "amount to anything more than . . . urging of performance" by the breaching party. *Id.* at 622. In this regard, the Court cited authority explaining that a breach victim's "urging performance and making 'efforts of its own to fulfill the conditions' of the contract come to the same thing." *Id.* The Court then explained the crucial requirement for loss of the right to restitution, namely, post-breach receipt of *contract performance* from the breaching party:

> Consequently the Government's waiver claim must come down to a claim that the companies *received* at least *partial performance*. Indeed, acceptance of *performance under a once-repudiated contract* can constitute a waiver of the right to restitution that repudiation would otherwise create.

Id. (latter two emphases added).

The Court went on to rely on this requirement in rejecting all three bases the Government advanced as showing forfeiture. First, the Court dismissed the *plaintiffs'* continued performance of the lease contracts, explaining:

> *The performance question, however, is not just about what the [plaintiffs] did or requested, but also about what they actually received from the Government.* And, in respect to the Exploration Plan, the companies received nothing.

Id. (emphasis added). Second, the Court ruled that, although plaintiffs "did at least receive [a] reply" from the Government to a certain post-breach request, that reply was insufficient to bar restitution – precisely because it was not "the kind of consideration for which their contracts called," *i.e.*, not *contract* performance from the Government under the relevant contracts. *Id.* at 622-23. Third, the Court rejected as insufficient the Government suspending of plaintiffs' obligations under their leases, stressing that the suspension was the result

of *other* Government duties (under a "separate contract"), so there was "no convincing reason why we should consider the suspensions to amount to significant *performance of the lease contracts in question*." *Id.* at 623 (emphasis added).

In short, the essential thing missing in *Mobil Oil* was post-breach Government *performance of the breached contracts*. Although both the Government and breach victim took various actions after the breach, those actions, individually and collectively, were legally inadequate to cause the victim to lose the right to restitution. The Court summarized: "We conclude that the companies *did not receive significant postrepudiation performance*. We *consequently* find that they did not waive their right to restitution." *Id.* (emphasis added).

The Federal Circuit decision in the present case cannot be squared with *Mobil Oil*. Whatever Old Stone did, and whatever else the Government was doing (under regulatory or other contractual authority), there was no actual or even expected post-breach performance of the breached contracts by the Government. In these circumstances, *Mobil Oil* precludes the Federal Circuit's "election" ruling.

2. *Mobil Oil* embodies the recognized logic of election in the restitution context. *Restatement* § 378 requires, for election, that the remedy be "inconsistent" with post-breach conduct. *See also id.* cmt. *d*. The precondition for any "inconsistency," however, as *Mobil Oil* makes clear, is that the victim's post-breach conduct must be a choice to continue receiving *contract performance*, thereby negating a claim of contract termination as a premise for restitution. The Federal Circuit missed that core point when, in quoting *Restatement* § 378, it overlooked the threshold "inconsisten[cy]" requirement and focused only on the *additional* requirement of detrimental reliance. App. 18a n.8. Without *contract performance* by the breaching party (actual or expected), however, a breach victim's conduct is not inconsistent with restitution, because it implies no claim by the victim to continuation of

the contract, *i.e.*, to receiving the breaching party's further performance in this inherently bilateral exchange. *Restatement* §§ 3, 17 (contract requires exchange).

Besides the logical meaning of continuing a contract, a simple policy underlies insistence on the essential precondition for an election. If the breach victim's mitigation efforts were themselves enough to result in forfeiture of the otherwise-clear restitution right, such mitigation efforts would be sharply discouraged and, therefore, curtailed – often to the detriment of the breaching party as well as victim. One of the authorities cited by the Federal Circuit, the *Corbin* treatise, makes this point. Explaining that the required "inconsistency" should focus simply on whether there would be a double recovery (*Corbin* § 1223, at 485, 489), the treatise stresses the danger of discouraging post-breach mitigation efforts:

> The supposed necessity of "election" between [damages and restitution] should by no means b[e] permitted to hamstring the injured buyer in his own efforts to mitigate his loss . . . .

Corbin § 1223, at 486. Yet discouraging mitigation efforts, by attaching an election penalty to them, is precisely what the Federal Circuit has done in this case, producing greater harm to breach victims, greater liability for breaching parties, and, in the context of federally insured institutions, greater liability for the Government.

3. The Federal Circuit's "election" ruling finds no sound support in either the sources it cited or its brief statement of a policy rationale. Like *Corbin* (just discussed), the Federal Circuit's principal authority, *Williston*, nowhere says that election can be found by post-breach actions that neither accept nor are taken in expectation that they will produce performance of the breached contract by the breaching party. Rather, the text requires action "to continue the contract," "to keep the contract in force," as a precondition for election, and

it effectively equates that concept to "electing to continue receiving benefits pursuant to the agreement." *Williston*, *supra*, at 644-45.[7]

The Federal Circuit offered only one passing rationale for its conclusion that an election must be found in this case – that a "moral hazard" would result if a breach victim could "act as if the contract remain[ed] fully in force . . ., run up damages, and then go suddenly to court." App. 19a-20a. This is not a sound reason for finding an election, because contract law already, and independently, addresses any such concern. As to pre-breach invested dollars, that amount is fixed at the time of breach and cannot be "run up." As to post-breach expenditures (which the Federal Circuit here permitted to be returned), any recovery is strictly controlled by governing law: in particular, mitigation payments cannot be recovered unless reasonable. *See* App. 9a, 13a-14a (citing authority for reasonableness restriction). Thus, there is no "moral hazard" that can support finding an election by post-breach mitigation efforts, which should be encouraged, not discouraged, to reduce the loss to all parties.

Any reliance on moral hazard is especially out of place in a case, like this one, in which the post-breach mitigation efforts were *compelled* by the Government. The Federal Circuit did not disturb the trial court's findings that the Government forced the post-breach mitigation efforts on Old Stone's part. *See* pages 3-4, *supra* (noting threats of using cease-and-desist powers and penalties). Indeed, the Federal Circuit observed that the Government was using "regulatory mechanisms to

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[7] The *Calamari & Perillo* treatise likewise does not say, or cite any cases holding, that an election can exist without post-breach actual or expected contract performance by the breaching party. The sole example the treatise gives of the victim "continu[ing] to perform after failure of condition" is one in which the breaching party is continuing its performance after the breach (its ship continues to sail). *Calamari & Perillo* § 11.32, at 445-46.

force" Old Stone's action. App. 18a n.9. Those findings are themselves inconsistent with the Federal Circuit's passing suggestion that Old Stone might somehow have simply walked away from the bank upon breach. App. 18a-19a; *but see* 12 C.F.R. § 546.4 (detailed regulatory standards for any voluntary dissolution). Moreover, the Federal Circuit's express premise that Old Stone had a "continuing contractual obligation" to support its bank negates any supposed freedom to "elect" to abandon the bank. App. 18a n.9. And, in other *Winstar* cases approving restitution, the Government *refused* to allow owners of a thrift to return it upon Government breach, recognizing that additional harm would be caused by *en masse* resignation of officers and directors. *See RTC v. FSLIC*, 25 F.3d 1493, 1498 (10th Cir. 1994); *Far West Fed. Bank, S.B. v. OTS*, CV No. 90-103-PA, slip op. at 5-6, 12 (D. Or. May 23, 1991).

These same facts also undermine the Federal Circuit's finding of "detrimental reliance" – though such reliance itself is immaterial where the breaching party has not engaged in post-breach *contract performance* and cannot even be expected to do so. The Government, by demanding post-breach infusions of capital from Old Stone (infusions that were part of the bank when seized), was necessarily declaring that its best interests were served by such mitigation efforts. The Federal Circuit had no basis for ruling that the Government nonetheless was harmed as a result of the very action that it demanded as beneficial to it.

The Federal Circuit's sole ground for so ruling was its observation that Old Stone Bank's deficiency in a particular regulatory category called "risk-based capital" increased between the 1989 breach and the 1993 seizure. App. 19a n.11. But the conclusion does not follow from the premise. Decisively, the court cited no support for equating "risk-based capital" (one of several regulatory capital categories that regulators use) with the amount of the Government's net

liability upon seizure.[8] Any assessment of a change in net liability to the Government between 1989 and 1993 would require considering how Old Stone's continued operation of the bank affected its value, compared to a hypothesized Government takeover in 1989, including the facts that Old Stone's efforts shrunk the total assets and liabilities of the bank by $1.5 billion during that period (App. 68a; DX187 at 2, line 400; PX512 at 4, line 70) and restored the bank's "core earnings power" and rendered it profitable on an operating basis by 1993 (App. 76a). The Federal Circuit, which undertook no such assessment, could not properly find harm to the Government even viewed after the fact.

4. The Federal Circuit decision is also inconsistent with other decisions on what post-breach conduct forfeits a claim for restitution based on total breach. Notably, among the numerous federal decisions cited in *Williston* that involve a contract waiver or election issue, *none* finds an election without the victim's accepting or expecting post-breach contract performance from the breaching party, and several expressly reject election where that requirement is not met.[9]

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[8] "Risk-based capital" is a regulatory concept that does not represent the actual asset value of the institution: certain assets are deliberately undervalued for regulatory purposes. The shortfall of "risk-based capital" (from regulation-required levels) is thus *not* the difference between liabilities and assets and does not measure the liability the Government faces upon seizing an institution. *See* Office of Thrift Supervision Regulatory Handbook (Nov. 2003), Appendix A: Capital Adequacy at 120A.1-120A.10; 12 C.F.R. pt. 325, App. A (FDIC Statement of Policy on Risk-Based Capital: "The risk-based capital ratio focuses principally on broad categories of risk, however, the ratio does not take account of many other factors that can affect a bank's condition. . . . [enumerating other factors]")

[9] All the cited federal-court decisions that involve a contract waiver or election issue, except those discussed in text, are: *ARP Films, Inc. v. Marvel Entertainment Group, Inc.*, 952 F.2d 643, 646 (2d Cir. 1991) (election by conduct "to continue receiving benefits pursuant to the contract"); *H.B. Zachry Co. v. Travelers Indem. Co.*, 391F.2d 43, 48 (5th Cir.

The three decisions cited by the Federal Circuit likewise positively reinforce the requirement of such performance. *Barron Bancshares,* 366 F.3d at 1383 (Government waived defense of breach by investors where, throughout period of alleged breach, Government made promised payments and

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1968) (subcontractor continued to work expecting payment from breaching contractor); *Western Transmission Corp. v. Colorado Mainline, Inc.*, 376 F.2d 470, 472 (10th Cir. 1967) (upholding jury's *rejection* of waiver of breach when plaintiff continued performance "upon the urging of" breaching party); *Loew's, Inc. v. Cole*, 185 F.2d 641 (9th Cir. 1950) (acceptance of defendant's services); *Specialities Dev. Corp. v. C-O-Two Fire Equip. Co.*, 207 F.2d 753, 756 (3d Cir. 1953) (patent licensee continued to practice the licensed patent after patentee breach); *Bigda v. Fischbach Corp.*, 898 F. Supp. 1004, 1011, 1012 (S.D.N.Y. 1995), *aff'd*, 101 F.3d 108 (2d Cir. 1996) (election where plaintiff employee "continued to collect his paychecks"); *V.S. Intern., S.A. v. Boyden World Corp.*, 862 F. Supp. 1188, 1196 (S.D.N.Y. 1994) (licensee elected to continue selling under the licensed name); *Nat'l Westminster Bk., U.S.A. v. Ross*, 130 B.R. 656, 675 (S.D.N.Y. 1991), *aff'd*, 962 F.2d 1 (2d Cir. 1992) (borrower "continued to accept the benefits of the agreement in the form of continuing advances" from the allegedly breaching lender); *Filmline (Cross-Country) Productions, Inc. v. United Artists Corp.*, 865 F.2d 513 (2d Cir. 1989) (rejecting waiver); *Sitlington v. Fulton*, 281 F.2d 552, 555 (10th Cir. 1960) (purchaser kept possession of property after seller's breach and encouraged seller's expenditures to perfect sale); *Aleutian Constructors v. United States*, 24 Cl. Ct. 372 (1991) (Government accepted performance after contractor's alleged breach); *Nat'l Landscaping Co. v. Continental Cas. Co.*, 238 F. Supp. 793, 798 (W.D. Mo. 1965) (breach victim accepted breaching party's continued performance); *Polish v. Johnson's Serv. Co.*, 218 F. Supp. 387, 391 (E.D. Pa. 1963) (no election), *rev'd on other grounds*, 333 F.2d 545 (3d Cir. 1964); *Autrey v. Williams and Dunlap*, 343 F.2d 730, 736 (5th Cir. 1965) (victim of breach continued performance after breach and got paid); *Acme Process Equip. Co. v. United States*, 347 F.2d 509, 515 (Ct. Cl. 1965), *rev'd on other grounds*, 385 U.S. 138 (1966) (Government could not wait a year to cancel contract for alleged breach, "allow[ing] an unwary contractor to continue performance and thus incur large expenses"); *In re Braniff, Inc.*, 118 B.R. 819, 835-36, 842 (M.D. Fla. 1989) (even if lessee breached, lessor's post-breach conduct, negotiating terms of future payment, showed choice to continue, not terminate).

received investors' promised operation of the thrift); *Northern Helex*, 455 F.2d at 551 (*rejecting* election although victim continued performance); *Cities Service Helex*, 543 F.2d at 1314 (election where victim "accepted . . . government performance" after breach).[10]

The Federal Circuit decision in this case conflicts with decisions – of other circuits and of the Federal Circuit itself – in the *Winstar* setting particularly. In *Far West Fed. Bank, SB v. United States*, 119 F.3d 1358 (9th Cir. 1997), the Ninth Circuit awarded thrift acquirers restitution of all their initial investment, specifically rejecting an election-of-remedies defense even after they had actively sought post-breach contract performance from the Government by suing (without success, ultimately) for an injunction. Far West's owners guided the thrift through two years of post-breach deterioration without forfeiting their right to restitution. *Id.* at 1361-63, 1365-67. Similarly, in *RTC v. FSLIC*, the Tenth Circuit held that the thrift investors, like Old Stone here, were entitled to restitution, even though they operated the thrift after the breach. 25 F.3d at 1498.

The Federal Circuit, for its part, had previously held that "a non-breaching party does not waive the right to restitution 'where [it] continues to perform only for the purpose of preserving what [it] has already invested in the performance.'" *First Nationwide Bank v. United States*, 431 F.3d 1342, 1352 (Fed. Cir. 2005) (quoting *Restatement (First) of Restitution* § 68 cmt. b (1936), passage relied on in *Mobil Oil*, 530 U.S.

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[10] Other federal-court decisions are to the same effect. *Dunkin' Donuts of America, Inc. v. Minerva, Inc.*, 956 F.2d 1566 (11th Cir. 1992) (franchisee who, after franchisor breach, continued to run its shop using franchise name cannot later claim damages based on total breach); *ESPN, Inc. v. Office of Comm'r of Baseball*, 76 F. Supp. 2d 383, 388 (S.D.N.Y. 1999) (election of remedies where party asserting breach "continued to perform and continued to accept performance under the . . . Agreement" after the alleged breach).

at 622). Upholding an award of "restitution" (in terms) to a thrift acquirer who had continued operating its thrift post-breach, the court explained that "a non-breaching party is not required to create an even worse situation by abandoning all performance in order to preserve access to [the restitution] remedy." *Id.* The Federal Circuit's ruling in the present case requires just that. *First Nationwide* creates a sharp intra-circuit conflict over election based on post-breach performance.

Still, other Federal Circuit decisions have approved money-back restitution of plaintiffs' initial investments (after total breach) without treating the owners' continued operation of the thrift as forfeiting the restitution remedy. In *Landmark Land*, 256 F.3d at 1371, one of the *Winstar* test cases, the court approved restitution where the plaintiff continued to operate the thrift post-breach, managed the thrift into insolvency, lost the thrift to seizure two years after FIRREA, and did not sue until six years later. Likewise, in *Hometown Fin., Inc. v. United States*, 409 F.3d 1360, 1369-70 (Fed. Cir. 2005), *aff'g* 56 Fed. Cl. 477, 479-80, 484-85 (2003), the Federal Circuit upheld an award of money-back restitution to Hometown's owners even though they had continued to operate the thrift following the breach. The appropriateness of restitution was so clear that the Government accepted the trial court's restitution analysis, subject only to an (unsuccessful) argument that plaintiffs had committed a breach.

In short, for contracts generally, and in the *Winstar* setting particularly, the decision below contradicts *Mobil Oil*, undermines the policies served by the governing law, and creates inter- and intra-circuit conflicts. This Court should grant review to make clear that Old Stone did not lose its restitution right by its (compelled) post-breach mitigation efforts, where it did not accept, and could not even expect, any post-breach *contract performance* from the Government.

B. The "Windfall" Ruling – Barring Restitution If It Would Exceed the Value of Hypothesized Contract Performance – Conflicts with *Mobil Oil* and the Law of Contract Remedies Recognized in Other Decisions

The Federal Circuit's second basis for rejecting restitution, "windfall," introduces another incorrect new limit on the right of the victim of a sufficiently grave breach to get its money back. In a single paragraph, the Federal Circuit declared that restitution is barred if it would make the victim better off than if there had been "no breach" (App. 27a (internal quotation marks omitted)) and that this was such a case. The comparison to contract performance is necessarily the basis of the "windfall" ruling, because there cannot be "duplicative" recovery (*id.*) in return of two separately invested amounts – the post-breach $74.5 million and the original $118 million. The Federal Circuit's new legal limit on restitution and its application in this case warrant review.

1. The decision again squarely conflicts with *Mobil Oil*, which makes clear that restitution looks not to what would have happened *without the breach* (*i.e.*, if the contract had been performed) but instead to what would have happened *without the contract*. This Court expressly ruled that the Government must return to plaintiffs the money they invested under a contract aimed at obtaining certain oil and gas leases, even if the Government's *performance* would have resulted in a loss to the plaintiffs. The Court made this point twice, adopting the *Restatement*'s recognition of "[t]he right of the injured party under a losing contract to a greater amount in restitution than he could have recovered in damages." § 373, cmt. *d*.

In first stating the governing law, the Court explained that a total breach requires return of the invested money

> whether the contracts would, or would not, ultimately have proved financially beneficial to the companies. The Restatement illustrates this point as follows:
>
> > "A contracts to sell a tract of land to B for $100,000. After B has made a part payment of $20,000, A wrongfully refuses to transfer title. B can recover the $20,000 in restitution. The result is the same even if the market price of the land is only $70,000, so that performance would have been disadvantageous to B." § 373, Comment *a,* Illustration 1.

530 U.S. at 608. The Court then relied on this principle to reject the argument that no restitution was due because the breach "could not have hurt the companies," which, the Government said, "could not have explored (or ultimately drilled) for oil in any event" (given other legal requirements) even if the contract had been performed. *Id.* at 623.

> This argument, however, misses the basic legal point. The oil companies do not seek damages for breach of contract. They seek restitution of their initial payments. Because the Government repudiated the lease contracts, the law entitles the companies to that restitution whether the contracts would, or would not, ultimately have produced a financial gain or led them to obtain a definite right to explore. See *supra,* at 608. If a lottery operator fails to deliver a purchased ticket, the purchaser can get his money back – whether or not he eventually would have won the lottery. And if one party to a contract, whether oil company or ordinary citizen, advances the other party money, principles of restitution normally require the latter, upon repudiation, to refund that money. Restatement § 373.

530 U.S. at 623-34. *Mobil Oil* is thus explicit that the value of performance does not limit the right to restitution of invested amounts upon a sufficiently serious breach. The

Federal Circuit decision in the present case is directly to the contrary.

2. The Federal Circuit's decision here is also contrary to its own previous decisions. On remand from this Court's decision in *Mobil Oil* itself, the Federal Circuit rejected the Government's continuing effort to avoid returning to plaintiffs the money they had invested, holding that it was irrelevant whether *performance* of the breached contract would have given the plaintiffs less than the amounts they paid in contracting for the performance. *Marathon Oil Co. v. United States*, 236 F.3d 1313, 1315 (Fed. Cir. 2000). That ruling squarely contradicts the Federal Circuit's ruling in this case.[11]

In other decisions, too, the Federal Circuit and its predecessor have recognized that restitution is *not* directed at restoring the plaintiff victim to the pre-*breach* situation, but focuses instead on the pre-*contract* situation. Long ago, the Court of Claims explained: "The purpose is to restore the injured party to the pre-contract status quo, not to put him in his post-contract position." *Acme Process*, 347 F.2d at 528; *id.* at 530 ("restitution is permitted as an alternative remedy for breach of contract in an effort to restore the innocent party to its pre-contract status quo"). In the *Winstar* setting, the Federal Circuit recognized that the remedy's function is "to restore the innocent party to its pre-contract status quo, and not to prevent the unjust enrichment of the breaching party."

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[11] The United States appeared to recognize the principle in its response to the rehearing petition in *Hansen*, *supra* (*see* note 5, *supra*). While seeking to distinguish *Hansen*, the Government acknowledged that when "the non-breaching party paid money for contract performance which, as a result of a breach, it never received[, t]he simplest remedy . . . consists of an award to the non-breaching party in an amount equal to the amount it paid. This result is not incorrect, *even if performance of the contract would have resulted in a loss for the plaintiff* . . . ." U.S. Resp. to Rehearing in *Hansen Bancorp, Inc. v. United States*, Fed. Cir. Nos. 03-5029, -5061 (Aug. 4, 2004), at 6 (emphasis added).

LaSalle Talman Bank, FSB v. United States, 317 F.3d 1363, 1375 (Fed. Cir. 2003). In another decision – which for years provided the pathmarking, governing framework for all the *Winstar* damages cases – the court explained: "The idea behind restitution is to restore–that is, to restore the non-breaching party to the position he would have been in had there never been a contract to breach." *Glendale Fed. Bank, FSB v. United States*, 239 F.3d 1374, 1380 (Fed. Cir. 2001).

The decision in this case conflicts with the foregoing decisions. It conflicts, too, with the Second Circuit's decision in *Bausch & Lomb Inc. v. Bressler*, 977 F.2d 720 (2d Cir. 1992). The Second Circuit there ruled that "restitution is available even if the plaintiff would have lost money on the contract if it had been fully performed" (and remanded for a determination under the restitution standard). *Id.* at 730. That ruling about ordinary common-law principles of contract and restitution – which federal government contract law follows (*Mobil Oil*, 530 U.S. at 607) – is contrary to the Federal Circuit's new rule.

3. The Federal Circuit in this case compounded its error in creating a new legal limit on restitution by engaging in an appellate pronouncement of facts contrary to the trial court's express factual findings, without making the required clear-error inquiry. Whereas the Federal Circuit simply declared that restoring the original investment (plus the post-breach investment) would make Old Stone better off than if there had been no breach, the trial court had specifically found that there was "no credible evidence that returning [Old Stone's] investment would place it in a better position than it would have been [in] had the Government not breached its contract." App. 94a. The Federal Circuit did not even acknowledge that finding of fact, let alone give it the deference it warrants under Federal Rule of Civil Procedure 52, which mandates respect for trial-court findings unless they are clearly erroneous. *See Dennison Mfg. Co. v. Panduit Corp.*, 475 U.S. 809 (1986) (ordering Federal Circuit to apply clear-error standard to factual findings).

A clear-error review would preserve the trial court's finding in this case. The trial court found that the bank would not have failed without the Government breach and, indeed, that Old Stone would have kept its "crown jewels" without the breach. App. 75a, 76a, 78a. There is simply no proof that Old Stone, with its crown jewels intact and an operational bank, would have been worse off than with a restitution award of $118 million many years later. The Federal Circuit thus could not declare that restitution made Old Stone better off than if there had been no breach even if that inquiry were legally relevant.

C. The Federal Circuit's Decision Will Produce Substantial Harm, Both to Private Parties and to the Government

Review is warranted in this case not only because the decision conflicts with *Mobil Oil* and with the law recognized in other decisions of other circuits and of the Federal Circuit. Review is also warranted because error or even confusion within the Federal Circuit on an important matter of federal contract law is uniquely harmful. That circuit has exclusive appellate jurisdiction in contract damages cases against the Government, whether brought originally in the Court of Federal Claims or in district court, as well as over appeals (by the contractor *or* the Government) under the Contract Disputes Act. 28 U.S.C. §§ 1295(a)(2) & (3), 1295(a)(10), 1346(a)(2), 1491(a)(1). Government contractors and the Government itself will have their behavior, and their ability to secure proper remedies, uniquely affected by Federal Circuit precedent.

The dramatic curtailment of restitution, if allowed to stand, will do continuing harm both to contractors and to the Government itself. One source of harm is the injustice of denying return of the investment when the Government commits so substantial a breach as to render the breach "total." That injustice is the heart of this Court's decision in *Mobil Oil*.

In addition, the Federal Circuit's decision will cause several forms of post-breach harm that flow from its discouragement of mitigation efforts by victims of Government breaches. Across the broad spectrum of Government contracting, such discouragement will often disadvantage the Government, as mitigation efforts may well reduce the harm for which the Government as breaching party would otherwise have to pay damages. Mitigation efforts should be encouraged, not disfavored by the threat that they will lead to forfeiture of the remedy of simple restitution.

In the area of Government-insured institutions particularly, the discouragement of mitigation efforts could cause additional harm. Mitigation efforts, if not discouraged, can be counted on sometimes to save the institution and often to reduce the harm to the institution – as the Government recognized in demanding post-breach capital infusions in this case. Mitigation efforts thus can lighten, or even eliminate, the burden of seizures borne by the Government. Yet the Federal Circuit has discouraged such efforts by penalizing them (in an area where there is always a continuing regulatory entanglement between the Government and contract parties) and thereby increased the burdens the Government faces not only as a contract defendant but as the insurer responsible for failed institutions.

Aside from its post-breach effects, the Federal Circuit's decision sharply restricting restitution will cause a systemic harm at the front end of the contracting process, as made evident by the principal opinion in *Winstar*, 518 U.S. at 883-85. Curtailing private parties' right to get their money back upon total breach, like the broad invocation of "unmistakability doctrine" to limit contract enforcement in *Winstar*, would place federal contract law "at odds with the Government's own long-run interest as a reliable contracting partner in the myriad workaday transaction of its agencies." *Id.* at 883. Some parties will be deterred from contracting with the

Government – whose costs of contracting will rise from that deterrence and, in any event, from the greater risks of participation. Thus, the decision here will "produce the untoward result of compromising the Government's practical capacity to make contracts" by "increasing the cost of its engagements." *Id.* at 884.

In short, the decision in this case, by the appellate court whose precedents matter most to all participants in government contracts, threatens broad harm through its severe curtailment of the remedy of restitution.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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December 14, 2006

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS,
FEDERAL CIRCUIT

No. 05-5059

OLD STONE CORPORATION,
Plaintiff-Appellee,

v.

UNITED STATES,
Defendant-Appellant.

May 25, 2006

Before LINN, DYK, and PROST, *Circuit Judges.*

DYK, *Circuit Judge.*

This is a *Winstar* damages case. *See United States v. Winstar Corp.*, 518 U.S. 839 (1996). The United States appeals the decision of the United States Court of Federal Claims, which awarded to Old Stone Corporation ("OSC") $192.5 million in damages for the government's breach of contract. *Old Stone Corp. v. United States*, 63 Fed. Cl. 65 (2004) ("*Old Stone II*"). The breach was the elimination of regulatory capital by the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), Pub.L. No. 101-73, 103 Stat. 183. We affirm the award of $74.5 million of post-breach mitigation payments, but reverse the award of $118 million of initial contributions. We conclude that the $118 million amount is not recoverable under a restitution theory because the appellant elected to continue performance under the contract to the

benefit of the appellant and to the detriment of the government, and is not recoverable under a reliance theory because the damages were not foreseeable as a matter of law.

BACKGROUND

I

Before the transactions that are the focus of this lawsuit, Old Stone Corporation ("OSC") was a bank holding company headquartered in Rhode Island. Its primary subsidiary was a commercial bank, Old Stone Bank ("Old OSB" or "OOSB"), which was insured by the Federal Deposit Insurance Corporation ("FDIC"). This dispute had its genesis in the acquisition of two thrifts by OSC.

The first transaction was an acquisition of a small thrift, Rhode Island Federal ("RIF"). In June 1984, OSC submitted a proposal to the Federal Savings and Loan Insurance Corporation ("FSLIC") to acquire RIF with cash assistance from FSLIC. As a result of the acquisition, OSC would become a "thrift holding company" owning all of the stock of RIF. OSC would also obtain a federal savings bank charter which would permit it to engage in commercial lending while allowing it to expand into other geographical areas.

FSLIC accepted OSC's offer and approved the transaction in August 1984. The transaction involved the following steps: (1) RIF converted from a mutual savings institution to a Federal stock savings bank (or "thrift"), "New" Old Stone Bank ("OSB"); (2) OSB formed a subsidiary, NEWCO, to which OSC transferred all of its stock in OOSB, valued at $103.2 million; (3) NEWCO caused OOSB to distribute its assets and liabilities to OSB; (4) OSC acquired all of OSB's stock for a nominal amount ($100).

Under an "Assistance Agreement" executed by OSC, FSLIC and OSB, FSLIC contributed $9.55 million cash to OSB, and OSC contributed $13.8 million cash. RIF's deficit net worth

on the date of the acquisition, after the cash contributions, was $4.4 million, which was recorded as so-called "supervisory goodwill." The Assistance Agreement incorporated a Forbearance Letter, which obligated the government to permit OSB to count FSLIC's $9.55 million cash contribution (known as a "capital credit"), and the $4.4 million of goodwill as regulatory capital. Thus the RIF transaction generated approxi mately $13.95 million in regulatory capital—$4.4 million in goodwill, and $9.5 million in the form of a capital credit. The Forbearance Letter permitted OSB to amortize this regulatory capital over a thirty year period. Because the Forbearance Letter was incorporated into the Assistance Agreement signed by OSC, FSLIC and OSB, the government's promise of regulatory forbearance ran to both OSC and OSB.

OSC and FSLIC also executed a Net Worth Maintenance Stipulation ("NWMS") under which OSC agreed to downstream (contribute) additional funds needed to maintain OSB in compliance with regulatory requirements.

The second transaction (the "Citizens transaction") occurred on December 27, 1985. OSC acquired Citizens Federal, a FSLIC-insured, federally-chartered mutual association located in Seattle, Washington. As part of the transaction, Citizens Federal converted to a federal stock savings bank and was renamed Old Stone Bank of Washington ("OSBW"). Under an Assistance Agreement between FSLIC, OSC and OSBW, FSLIC contributed $78.5 million of cash assistance to OSBW, and OSC contributed $14.8 million. Taking into account the cash contributions, the bank had a net worth deficit of $2.76 million. This amount was recorded as supervisory goodwill. The Assistance Agreement incorporated a Forbearance Letter, which permitted OSBW to count FSLIC's $78.5 million contribution, and the $2.76 million of supervisory goodwill as regulatory capital. Thus the Citizens transaction generated a total of $81.26 million in regulatory capital—$2.76 million in goodwill, and $78.5 million in

capital credits. The Forbearance Letter permitted OSBW to amortize that regulatory capital over twenty five years. As in the RIF agreement, the government's promise of regulatory forbearance ran to both the thrift and to OSC.

On December 31, 1986, OSBW (formerly Citizens Federal) merged with and into OSB. Thereafter the combined OSB-OSBW entity made regulatory filings on a consolidated basis and was regulated on the basis of its combined regulatory capital.

The government contends that on December 31, 1987, the parties agreed to terminate the Citizens Assistance Agreement, pursuant to a termination provision of the Assistance Agreement that provided that "this Agreement shall terminate five years following the Effective Date *or on such other date to which the parties or their successors agree in writing . . .*" J.A. at 200185 (emphasis added). The parties dispute the effect of this termination on the government's regulatory capital promise, but agree that it terminated the government's obligation to make assistance payments under the agreement.

II

In August of 1989, Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub.L. No. 101-73, 103 Stat. 183. ("FIRREA"), which limited the ability of thrift institutions to count supervisory goodwill and capital credits towards their regulatory capital requirements. *Winstar*, 518 U.S. at 856-60.

At the time of the enactment of FIRREA, approximately $80 million of regulatory capital from the Citizens and RIF transactions had not yet been amortized pursuant to the 30-year and 25-year amortization provisions of the assistance agreements. Approximately $11.7 million of this capital was attributable to the RIF transaction, and the remainder to the Citizens transaction. FIRREA prevented OSB from recognizing these amounts as regulatory capital. As a result, OSB

failed one of the government's regulatory capital requirements-the so-called "risk-based" capital requirement-by $36 million.[1] OSB was thus "undercapitalized" and subject to seizure. However, neither OSC nor OSB repudiated the assistance agreements or at the time filed suit against the government for breach of the contracts. Rather, OSC and OSB sought to achieve compliance with FIRREA, and to otherwise continue performance under the contract.

A thrift could address the problem of regulatory compliance created by FIRREA in one of two ways—either by shrinking the thrift (selling assets and using the proceeds to pay off liabilities) or by infusing additional capital into the thrift. Initially the thrift chose the former route.[2] It sold assets in December of 1989—a residential lending unit ("OsCal") and a tuition budget company ("Academic Management Services" or "AMS").

Thereafter OSB submitted a "Capital Plan," which required OSB to "maintain . . . compliance with the tangible and core capital requirements" and to meet the risk-based capital requirement of FIRREA by December 31, 1990. J.A. at 200935. Under the Plan, the government granted an "exemp-

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[1] Thrifts are regulated under FIRREA by reference to capital ratios—i.e., the ratio of capital to assets. The "risk-based" capital ratio "is obtained by dividing [the thrift's] capital base . . . [which includes, *inter alia*, 'common stockholders' equity'] by its risk-weighted assets . . . ." 12 C.F.R. Pt. 3, App. A (1990). Two other capital requirements are "tangible capital" and "core capital." The thrift here was in compliance with these latter two requirements.

It appears that the Court of Federal Claims erroneously referred to the unamortized amount of regulatory capital remaining on the date of seizure as $75 million. *Old Stone II*, 63 Fed. Cl. at 89.

[2] A bank may improve its capital ratio either by increasing capital (as by receiving an infusion of cash) or by shrinking its asset base. *Old Stone II*, 63 Fed. Cl. at 73. The asset base is shrunk by selling off assets and using the cash proceeds to repay liabilities.

tion from any penalties or sanctions that may be imposed on the [thrift] for failing to meet its capital requirements." J.A. at 200930. The Capital Plan called for further shrinkage of the thrift through the sale by OSB of the assets that were owned by Citizens before the merger of Citizens into OSB. On January 25, 1990, OSB entered into a definitive agreement to sell all of the branches of OSBW (formerly Citizens). It sold the assets in May 1990, for a gain of $9.2 million.

The Plan also required OSC to contribute additional capital under the NWMS, pursuant to a revised schedule. The government approved the Plan in March 1990. Pursuant to the Plan, OSC downstreamed $74.5 million of capital to OSB in three allotments: $45.463 million in 1990, $27.5 million in 1991 and $1.6 million in 1992. In order to fund these downstream payments, OSC sold assets including two of its subsidiaries, Old Stone Credit Corp and Old Stone Bank of North Carolina. OSC refers to these subsidiaries as its "crown jewels." The record does not reflect the exact relationships between the 1990, 1991 and 1992 payments and the amount of unamortized regulatory capital at the time of each payment, but the parties agree that these payments were even greater than the amount of unamortized regulatory capital ($65 million)[3] when the thrift was later seized in 1993.

It is undisputed that after the breach caused by the enactment of FIRREA, OSC was suffering from significant problems unrelated to the lost regulatory capital. As the Court of Federal Claims found, "Old Stone acknowledges that factors other than the breach affected the bank's operations during the period after the breach." 63 Fed. Cl. at 88. The court also found that "[t]hese problems resulted in part because of general economic conditions at the time." *Id.* However, OSC

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[3] OSC stated that the amount of unamortized regulatory capital "approximately $65 million." Pl's Supp. Br. at 9. There was some testimony that might support a finding of $68.5 million.

contended, as its expert stated, that "[w]hat the breach did was [take] away our ability to weather the storm, to solve the *[other] problems*." *Id.* at 89 (emphasis added).

III

Three years after the enactment of FIRREA, OSC and OSB filed a complaint in the Court of Federal Claims against the United States on September 16, 1992, alleging that the passage of FIRREA resulted in the breach by the government of contracts embodied in the RIF and Citizens assistance agreements, under which the government was obligated to permit the thrift to count capital credits and goodwill as regulatory capital. The complaint requested, *inter alia*, recovery of damages OSB had allegedly suffered in attempting to maintain regulatory compliance, and $15 million OSC had invested when it acquired Citizens.

On January 29, 1993, the government seized OSB and placed it in receivership. OSB was at that time "critically undercapitalized" under the statute because it had less than two percent tangible equity. As noted above, absent the enactment of FIRREA, on the 1993 date of seizure the unamortized balance of regulatory capital would have been approximately $65 million.

The Court of Federal Claims action was stayed pending the Supreme Court's decision in *Winstar*, 518 U.S. 839, and pursuant to a pretrial agreement concerning many of the *Winstar* actions.

Eventually, after discovery, on April 10, 2003, the Court of Federal Claims granted summary judgment in favor of OSC on the issue of liability, finding that the enactment of FIRREA had breached the Assistance Agreements. *Old Stone Corp. v. United States*, No. 92-647C (Fed. Cl. Apr.10, 2003) ("*Old Stone I*"). In that connection the court rejected the government's argument that the regulatory capital promises had been terminated by the parties pursuant to Section 15

of the Citizens Assistance Agreement before the enactment of FIRREA. *Id.*, slip op. at 6-7. The court appeared not to address the government's contention that the promise of regulatory forbearance under the Citizens Assistance Agreement should not be considered because that promise would have ceased upon the sale of the OSBW assets in May 1990 without regard to the enactment of FIRREA.

A trial on damages was held beginning in May 2004. *Old Stone II*, 63 Fed. Cl. at 68. Following the trial, the Court of Federal Claims awarded OSC the following amounts in damages: (a) $74.5 million for the "post-breach" contributions OSC made to OSB after the enactment of FIREEA, under mitigation and reliance theories; (b) $103.2 million for the value of stock OSC transferred to the thrift in the RIF acquisition, under restitution and reliance theories; and (c) $14.8 million for the cash contribution OSC made to Citizens in the Citizens acquisition, under restitution and reliance theories. These damages totaled $192.5 million.[4] In awarding these amounts, the court reasoned that the government's breach caused all of OSC's losses, because absent FIRREA, OSB would have had an additional $65 million in regulatory capital and would not have been seized. The court held that the requirements of restitution had been met because the contributions conferred a benefit on the government, and because the enactment of FIRREA constituted a total breach. The court rejected the government's argument that continued performance by OSC constituted an election that barred voiding the contract and seeking restitution. In finding that the $192.5 million should be awarded as reliance damages, the court found that the losses were foreseeable. The court also rejected the government's argument that returning the initial investments would result in a "windfall" to OSC.

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[4] OSC abandoned a claim to an additional $13.8 million that it allegedly contributed to the RIF transaction.

The government timely appealed. Following oral argument, we ordered supplemental briefing on a variety of questions. We have jurisdiction pursuant to 28 U.S.C. § 1295(a)(3).

DISCUSSION

We review the Court of Federal Claims' decisions on summary judgment and conclusions of law without deference. *Comtrol, Inc. v. United States*, 294 F.3d 1357, 1362 (Fed. Cir. 2002); *Alger v. United States*, 741 F.2d 391, 393 (Fed. Cir. 1984). We review the court's findings of fact following trial under the clearly erroneous standard. *Anderson v. City of Bessemer City*, 470 U.S. 564, 573-76 (1985); *Home Savings of Am. v. United States*, 399 F.3d 1341, 1347 (Fed. Cir. 2005).

I

We first address the Court of Federal Claims' holding that under a mitigation theory OSC is entitled to recover the $74.5 million in downstream payments that it made to OSB in order to replace the regulatory capital eliminated by FIRREA. When FIRREA was enacted in August of 1989 it eliminated $80 million of regulatory capital that was available to OSB under the assistance agreements. By the time of seizure of the thrift in January 1993 the unamortized regulatory capital deficiency would only have been $65 million. Between the enactment of FIRREA and the seizure, OSC downstreamed $74.5 million to OSB to replace the regulatory capital lost by FIRREA. That amount is claimed and was allowed by the Court of Federal Claims on a theory of mitigation. Neither party disputes that the downstreamed amounts exceeded the unamortized regulatory capital which remained at the time of the seizure.

A non-breaching party may generally recover its mitigation costs incurred in a reasonable effort to avoid loss caused by a breach, even if its efforts prove unsuccessful. *Restatement (Second) of Contracts* §§ 350 cmt. h; *id.* at § 347 cmt. c (1981)

("[T]he injured party is [generally] entitled to recover for all loss actually suffered."). Consistent with this rule, we have upheld awards of the actual costs of generating replacement capital resulting from the elimination of regulatory capital by FIRREA. *See, e.g., Home Savings*, 399 F.3d at 1353; *Cal. Fed. Bank, FSB v. United States*, 245 F.3d 1342, 1350 (Fed. Cir. 2001) (affirming award of transaction costs as measure of cost of replacing capital) ("*Cal Fed*"); *see also Hughes Commc'ns Galaxy, Inc. v. United States*, 271 F.3d 1060, 1066 (Fed. Cir. 2001).

In *Home Savings*, for example, we affirmed an award of the cost incurred by shareholders in replacing supervisory goodwill eliminated by FIRREA. 399 F.3d at 1354. Likewise, in *LaSalle Talman Bank v. United States*, 317 F.3d 1363 (Fed. Cir. 2003), we affirmed an award of the cost of raising replacement capital "because it provides a measure of compensation based on the cost of substituting real capital for the intangible capital held by plaintiff in the form of supervisory goodwill." *Id.* at 1374. In our prior "cost of replacement" cases, the thrift was not seized and the replacement capital was not lost, so the cost of replacing the capital was limited to the cost of raising additional capital and did not include the replacement capital itself. Here, the Court of Federal Claims held that OSC's cost of replacing OSB's supervisory goodwill with tangible capital was not just the transaction costs incurred in raising the $74.5 million, but rather the $74.5 million itself.

We understand the government to contend that the Court of Federal Claims made several errors in allowing the $74.5 million as mitigation costs.

First, the government contends that the regulatory capital promise with respect to the Citizen's acquisition was eliminated by agreement in December 1987, before the enactment of FIRREA, and that FIRREA thus did not cause a breach of the government's promise. Since there was no breach of the

Citizens agreement, there can be no recovery of mitigation payments that replaced the Citizens capital. Because only $11.7 million of RIF capital remained on the date of FIRREA, any mitigation payments in excess of $11.7 million are attributable to Citizens and are not recoverable.

There is no dispute that the Citizens agreement was terminated. The question is whether the termination applied to both executory (i.e., financial assistance) and non-executory (i.e., regulatory forbearance) provisions. The government asserts that the termination applied to both obligations and eliminated its obligation of regulatory forbearance before the enactment of FIRREA. The government agrees that the termination is described in a December 31, 1987, letter FHLBB sent to OSB stating that "[t]his letter serves as notification that the Assistance Agreement . . . has terminated as of December 31, 1987, pursuant to Section 15 of the Agreement." J.A. at 400003. Relying on our decision in *Winstar*, the Court of Federal Claims interpreted the parties' agreement to apply only to the executory provisions. *Old Stone I*, slip op. at 6-8. We agree with the Court of Federal Claims.

In *Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995) (*en banc*), *affirmed*, 518 U.S. 839 (1996), we held that a termination clause applied only to executory provisions. 64 F.3d at 1542. That termination clause stated in part, "[t]his agreement shall terminate and the obligations of the FSLIC to make any payments hereunder shall cease upon the expiration of 10 years . . . ." Glendale Federal Supervisory Action Agreement, § 9 (available in *Old Stone II* Supplemental Appendix (filed May 31, 2002)). The government claimed that after the passage of 10 years the regulatory forbearance expired. We rejected that construction and held that the "expiration provision . . . relat[ed only] to executory provisions set out in the SAA, which obligated the FSLIC to make certain payments to the merged thrift for a limited period of time." *Winstar*, 64 F.3d at 1542.

Section 15 of the Citizens Assistance Agreement is similar to the termination clause in the *Winstar* case. It provides that "this Agreement shall terminate five years following the Effective Date *or on such other date to which the parties or their successors agree in writing* . . . ." J.A. at 200185 (emphasis added). The emphasized language does not appear in the agreement involved in *Winstar*. However, this language merely allows the parties to accelerate the natural termination that would otherwise take place upon the passage of five years. That is exactly what the termination agreement did. It refers specifically to Section 15. J.A. at 400003 ("This letter serves as notification that the Assistance Agreement . . . has terminated as of December 31, 1987, *pursuant to Section 15 of the Agreement.*") (emphasis added). Thus the termination agreement did no more than accelerate a termination provision that was not designed to eliminate the promises of regulatory forbearance. The termination only applied to executory provisions, and the regulatory forbearance remained in force on the date of the enactment of FIRREA.

Second, the government argues that, even if the Citizens contract were not voluntarily terminated in 1987, any contractual right to count the Citizens capital credits and goodwill as regulatory capital would have ceased with the sale of Citizens/OSBW in May 1990. Again the government argues the amount of mitigation recovery should be reduced by eliminating payments that replaced the regulatory capital under the Citizens agreement and thus should be confined to $11.7 million (the amount under the RIF agreement).

After the execution of the two assistance agreements in 1984 and 1985, the two thrifts merged into OSB on December 31, 1986. The government admits that the merged entity could claim the benefit of both assistance agreements. However, the government contends that the merged entity lost the right to enforce the Citizens Assistance Agreement when the Citizens assets were sold in May 1990. The government con-

tends that Section 13 of the Citizens Assistance Agreement provides that generally accepted accounting principles ("GAAP") govern accounting computations made under the Agreement. It asserts that GAAP rules required that the goodwill attributable to the Citizens transaction be written off upon the sale of the Citizens assets. At that point, says the government, the Citizens agreement would no longer be enforceable.

Again we do not agree. The sale of the OSBW assets occurred *after* the enactment of FIRREA, and the Court of Federal Claims found that FIRREA caused the sale of the Citizens assets. *Old Stone II*, 63 Fed. Cl. at 72 ("Old Stone's Capital Plan also represented . . . that management would 'mitigate the capital reduction [by] . . . sell[ing] certain subsidiaries [including] . . . the Seattle, Washington-based thrift that was a division of Old Stone Bank [i.e., Citizens].'"). On this point, the Court of Federal Claims' finding is supported by the record.

Finally, the government contends that the amount of mitigation recovery should be limited to $36 million rather than the $74.5 million awarded by the Court of Federal Claims because OSB needed only $36 million to bring it into capital compliance immediately after the enactment of FIRREA.

In *Home Savings*, we recognized that "[w]hen mitigating damages from a breach, a party 'must only make those efforts that are fair and reasonable under the circumstances.'" 399 F.3d at 1353 (quoting *Robinson v. United States*, 305 F.3d 1330, 1333 (Fed. Cir. 2002)); *see also* 11 *Corbin on Contracts* § 57.11, at 311 (2005 ed.) ("The doctrine of avoidable consequences merely requires reasonable efforts to mitigate damages."); 3 *Dobbs: Law of Remedies* § 12.6(1), at 127 (2d ed. 1993) ("[T]he damage recovery is reduced to the extent that the plaintiff could reasonably have avoided damages he claims and is otherwise entitled to."). The government has not shown that it was unreasonable for OSC to replace the

entire amount of regulatory capital that was eliminated by FIRREA.

In *Home Savings*, we allowed a mitigation award that exceeded the minimum amount required to achieve regulatory compliance. 399 F.3d at 1352-53. The *Home Savings* court held that the full cost was recoverable because the holding company "was entitled to raise funds to replace the supervisory goodwill [the thrift] lost as a result of the government's breach," *including* the "excess" capital beyond that needed to achieve regulatory compliance. *Id.* Likewise, OSC was entitled to replace the entire amount of regulatory capital eliminated by FIRREA so that the thrift had a cushion against future losses. We agree with the Court of Federal Claims conclusion here that OSC's mitigation efforts were reasonable under the circumstances.

For the forgoing reasons, we conclude that the Court of Federal Claims correctly held that OSC is entitled to recover its mitigation payments of $74.5 million.

II

We next address the Court of Federal Claims' holding, and OSC's argument, that OSC is entitled to recover its $103.2 million stock contribution to the RIF transaction, and its $14.8 million cash contribution to the Citizens transaction. OSC claims these amounts under restitution and reliance theories. We first consider its restitution theory.

When one party to a contract commits a total breach, the other party "is entitled to restitution for any benefit that he has conferred on" the breaching party "by way of part performance or reliance." *Mobil Oil Exploration, Prod. Southeast, Inc. v. United States*, 530 U.S. 604, 608 (2000) (citing *Restatement (Second) of Contracts* § 373 (1979)); *see also Landmark Land Co., Inc. v. F.D.I.C.*, 256 F.3d 1365, 1372 (Fed. Cir. 2001). A party may recover damages as restitution to the extent that party has conferred a benefit on the breach-

ing party. *Hansen Bancorp, Inc. v. United States*, 367 F.3d 1297, 1314 (Fed. Cir. 2004) (citing *Restatement (Second) of Contracts* § 373); *see also Cal Fed.*, 245 F.3d at 1350-51 ("The idea behind restitution is to restore the non-breaching party to the position it would have been in had there never been a contract to breach.") (citing *Glendale Fed. Bank, FSB v. United States*, 239 F.3d 1374, 1380 (Fed. Cir. 2001)) ("*Glendale*").[5]

We have suggested that restitution of initial contributions of both stock and cash in *Winstar* transactions may be allowable because both forms of contribution confer a benefit on the government. *See, e.g.*, *Landmark*, 256 F.3d at 1372-73; *Hansen*, 367 F.3d at 1317. In *Landmark*, we held that restitution of an initial cash contribution to a supervisory merger was appropriate when the contribution was expressly required by the assistance contract. 256 F.3d at 1372-73. In *Hansen*, we indicated that it might be possible to consider a stock transfer as a "benefit conferred" in a *Winstar* case that would be subject to restitution. 367 F.3d at 1316-17.

Nonetheless, restitution is subject to an important limitation. Restitution is "available only if the breach gives rise to a claim for damages for total breach and not merely to a claim for damages for partial breach." *Id.* at 1309 (quoting *Restatement (Second) of Contracts* § 373 cmt. a). When a non-breaching party elects to continue performance, that party is said to elect to treat the breach as partial rather than total. 13 *Williston on Contracts* § 39:32 (4th ed.2000). The consequence is that restitution is not available, and the non-

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[5] In *Hansen*, we stated that where there has been a benefit to the breaching party "restitution may be measured by either 'the value of the benefits received by the defendant due to the plaintiff's performance' or 'the cost of the plaintiff's performance, which includes both the value of the benefits provided to the defendant and the plaintiff's other costs incurred as a result of its performance under the contract.'" *Hansen*, 367 F.3d at 1314 (quoting *Landmark*, 256 F.3d at 1372).

breaching party must pursue a claim for damages instead. *See* 12 *Corbin on Contracts*, § 1223 at 514-16 ("Damages and restitution will not be given as concurrent remedies for the same injury."). Our *Winstar* precedent has not yet considered the effect of the election doctrine on damages arising from the enactment of FIRREA.[6]

In describing the election doctrine, Williston states

> When one party commits a material breach of contract, the other party has a choice between two inconsistent rights--he or she can either elect to allege a total breach, terminate the contract and bring an action [for restitution], or, instead, elect to keep the contract in force, declare the default only a partial breach, and recover those damages caused by that partial breach . . . .

13 *Williston* § 39:32 (4th ed.2000).[7] In *Mobil Oil v. United States*, the Supreme Court recognized that the election doc-

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[6] However, our decisions have addressed the related doctrine of waiver, holding that continuing to receive payments under an assistance agreement is not a waiver of the right to recover damages for a breach (other than restitution). *Westfed Holdings, Inc. v. United States*, 407 F.3d 1352, 1360-61 (Fed. Cir. 2005). In *Westfed*, we rejected the argument that the holding company had waived the breach (and forfeited its right to recover reliance damages) by continuing to receive assistance payments from the government. As Williston makes clear, "[t]he doctrine of election and that of waiver should not be confused; an election is not a waiver of any rights under the contract but rather a choice between two inconsistent rights following a breach of the contract." Williston § 39:32; *see also id.* at n. 56 (citing case precluding waiver of breach but applying election doctrine); *cf. Barron Bancshares, Inc. v. United States*, 366 F.3d 1360, 1383 (Fed. Cir. 2004) (holding government waived right to assert prior material breach by performing under contract by making assistance payments to thrift).

[7] Joseph M. Perillo, *Calamari & Perillo on Contracts* § 11.32-11.33 at 462-66 (5th ed.2003); *see also Barron Bancshares*, 366 F.3d at 1383; *Cities Service Helex, Inc. v. United States* 211 Ct.Cl. 222, 543 F.2d 1306, 1313-15 (1976).

trine applies when the breach is the enactment of a statute. 530 U.S. 604 (2000).

The authorities differ on what conduct is required to establish an election. The Williston view appears to be that mere continued performance can result in an election. 13 *Williston* § 39:32 ("[A] party's actions are sometimes characterized as an election where that party continues to perform or to accept performance under a contract even though he or she knows that a contract provision has been breached."). Other authorities take a stricter position—that the mere failure to elect restitution at the time of the breach and the continuation of performance is not sufficient to result in an election. Rather, there must be either (1) detrimental reliance by the breaching party (here an injury to the government as the result of the delay), *see* 12 *Corbin* § 1220 (1993 ed.); *Restatement (Second) of Contracts* § 378; or (2) a benefit to the non-breaching party as a result of the delay (here a benefit to OSC), *see Mobil Oil*, 530 U.S. at 621-23.

The Supreme Court's decision in *Mobil*, in which the Court allowed a restitution remedy under a government contract, is ambiguous as to which standard applies. In that case the Court concluded that "[T]he Government [has not] convinced us that the companies' continued actions under the contracts amount to anything more than [the] urging of performance . . . . Consequently the Government's waiver claim must come down to a claim that the companies *received* at least partial performance." *Id.* at 622 (internal citations omitted) (emphasis in original). The Court concluded the plaintiff companies had not received partial performance from the government under the contracts after the breach. *Id.* at 623. While the decision is clear that the receipt of partial performance by the plaintiff will bar restitution (and the authorities cited make equally clear that detrimental reliance by the

government would also be a bar),[8] it is unclear as to whether a plaintiff's continued performance without the receipt of benefits or detrimental reliance would be sufficient to bar restitution.

Here we need not decide which standard governs, because even the stricter election rule is satisfied. OSC plainly continued to treat the assistance agreements as in place by deciding not to terminate the contracts or to file suit for restitution after the enactment of FIRREA. Indeed, OSC's claim for restitution was not asserted until three years later. Instead of electing to terminate the agreement after the enactment of FIRREA, OSC on March 13, 1990, some seven months after FIRREA, agreed to a new Capital Plan with the Office of Thrift Supervision ("OTS"), under which it once again agreed to comply with the Net Worth Maintenance Stipulations of the original contracts and to make payments to the thrift to bring it into compliance with the requirements of FIRREA.[9] *See Old Stone II*, 63 Fed. Cl. at 72 ("[OTS] approved the bank's Capital Plan conditioned on [OSC's] agreement that it would maintain the bank's capital position pursuant to the Net Worth Maintenance Stipulation.").

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[8] The authorities cited by the Supreme Court (*see Mobil*, 530 U.S. at 622) make this clear. *Restatement (Second) of Contracts* § 373 ("An injured party's right to restitution may be barred by election under the rules stated in §§ 378 and 379") (emphasis added); *Id.* at § 378 ("If a party has more than one remedy under the rules stated in this Chapter, his manifestation of a choice of one of them by bringing suit or otherwise is not a bar to another remedy unless the remedies are inconsistent and *the other party materially changes his position in reliance on the manifestation.*") (emphasis added).

[9] While the government could use regulatory mechanisms to force OSC to comply with its contractual obligation to infuse additional capital, see, e.g., *CityFed Financial Corp. v. Office of Thrift Supervision*, 58 F.3d 738, 741 (D.C. Cir. 1995), there is no claim that the government could have compelled OSC to infuse additional capital absent a continuing contractual obligation.

The government detrimentally relied on OSC's conduct. If OSC had elected to terminate the contract and seek restitution at the time of the enactment of FIRREA, the government could not have, and would not have, demanded that OSC make subsequent contributions to the thrift pursuant to the new Capital Plan and Net Worth Maintenance Stipulations of the terminated contracts[10] which resulted in the government's liability for $74.5 million in mitigation payments. And it is certain that the government would have seized the bank earlier, with the likely result that additional losses to the insurance fund would have been avoided.[11] There were also continued benefits to OSC received under the earlier agreements with the government—its ability to continue to operate the thrift; the government's willingness to defer enforcement of the obligation of OSC to contribute additional capital pursuant to the NWMS under the earlier agreements; the non-seizure of the thrift before 1993 (despite its non-compliance with FIRREA standards); and continued federal deposit insurance.[12]

The election doctrine is designed to avoid the very kind of moral hazard that would result here if the thrift could post-

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[10] *Old Stone II*, 63 Fed. Cl. at 82 ("[OSC] downstreamed $75 million to [OSB] pursuant to the Net Worth Maintenance Stipulation after breach.").

[11] As noted above, on the date of FIRREA, OSB failed the risk-based capital requirement by approximately $36 million. On the date of seizure, the risk-based capital shortfall had more than doubled, to $77.6 million.

[12] An FHLBB Memorandum recommending approval of RIF Assisted Acquisition confirms that OSC was to receive deposit insurance. It stated:

> The OFSLIC recommends that the Bank Board approve the proposal, which will result in [OSC] acquiring the stock of [RIF], upon [RIF's] conversion to a federal stock savings bank [RIF-FSB], and the transfer of OSB's charter and trust operations to a subsidiary [Newco] of [RIF-FSB]. The remaining assets and liabilities of [OSB] will be transferred to [RIF-FSB], *so [OSB's] deposit accounts will become FSLIC insured.*

J.A. at 200052 (emphasis added).

pone repudiation of the contract for several years, bet that it could make the thrift profitable, but secure restitution if the thrift failed. Our predecessor court, the Court of Claims, has recognized (in the waiver context), that "[a]s a general proposition, one side cannot continue after a material beach by the other . . . act as if the contract remains fully in force . . . , run up damages, and then go suddenly to court." *Northern Helex Co. v. United States*, 197 Ct.Cl. 118, 455 F.2d 546, 551 (1972).[13]

Despite the clear applicability of the election doctrine, OSC argues that a provision in the assistance agreements here bars the argument that OSC's election prevents it from claiming restitution. Section 13 of the RIF assistance agreement, and Section 16 of the Citizens assistance agreement, entitled "Rights and Forbearances," provide:

> The rights, powers, and remedies given to the parties by this Agreement shall be in addition to all rights, powers, and remedies, given by any applicable statute or rule of law. Any forbearance, failure, or delay by any party in exercising or partially exercising any such right, power, or remedy shall not preclude its further exercise.

J.A. at 200109-10. In light of this provision, OSC's failure to promptly assert a breach of contract did not, of course, result in a waiver of its right to assert a breach at a later time and recover damages. *See Westfed*, 407 F.3d at 1360-61 (holding plaintiff did not waive its right to assert breach by continuing

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[13] Our decision in *First Nationwide Bank v. United States*, 431 F.3d 1342, 1352 (Fed. Cir. 2005), does not foreclose an election theory. Although the *First Nationwide* court rejected an election argument and characterized the claim as one for "partial restitution," the plaintiff in that case claimed amounts that it was promised by the government, not amounts that it actually expended under the contract. Thus the claim in *First Nationwide* was not a true restitution claim. In any event, the plaintiff in *First Nationwide* "promptly protested the [breach], filing suit first against the FDIC and then against the United States" *Id.* at 1352.

to receive assistance payments from the government). But here the restitution remedy is not precluded by inaction—"forbearance, failure or delay" in exercising the right to restitution—but rather by OSC's taking an action-election among inconsistent remedies by continuing to perform. The quoted provision does not restore a remedy forfeited by continued performance. In other words, the "Rights and Forbearances" clause of the RIF and Citizens agreements does not preclude the application of the common law election of remedies doctrine.

For the foregoing reasons, we conclude that OSC's initial contributions are not recoverable under a restitution theory.

III

Nor are the initial contract payments of $118 million recoverable under a reliance theory.

The purpose of reliance damages is to compensate the plaintiff "for loss caused by reliance on the contract." *Restatement (Second) of Contracts* § 344(b). We have previously upheld awards of reliance damages in *Winstar* cases. *See, e.g., Westfed*, 407 F.3d at 1368, 1371. We have also held that reliance damages can be recovered for losses of pre-breach investments pursuant to the contract. *See id.*; *Glendale*, 239 F.3d at 1383.

The Court of Federal Claims found that the breach caused the seizure of OSB and the loss of OSC's investment. *Old Stone II*, 63 Fed. Cl. at 98 ("Defendant's breach was the cause of plaintiff's damages."); *id.* at 88 ("We think it highly unlikely that the regulators would have seized the bank in 1993, absent the breach."); *id.* ("[OSB's problems] would have been eased by the bank's having had a capital cushion.").

However, the Court of Federal Claims did not explain how the breach—the refusal to recognize the regulatory capital as promised in the assistance agreements—caused the seizure

when that regulatory capital had been replaced by the mitigation payments before the seizure occurred. On this critical question the Court of Federal Claims' opinion is unfortunately entirely silent. Despite the absence of findings by the Court of Federal Claims, OSC urges that the causation finding is supportable on two theories—that the breach caused the shrinkage of the thrift and on the alternative (and primary) theory that the breach caused the depletion of the assets of the holding company, and that these events caused the seizure of the thrift and the loss of the OSC investment.

But even assuming that FIRREA caused the seizure by putting in motion this chain of events, reliance damages are subject to two pertinent limitations—the damages must have been both proximately caused by the breach, and foreseeable. *Hughes*, 271 F.3d at 1066.

As we have repeatedly held, "[i]n order to be recoverable as reliance damages, . . . plaintiff's loss must have been foreseeable to the party in breach at the time of contract formation." *Westfed*, 407 F.3d at 1365 (quoting *Landmark*, 256 F.3d at 1378); *see Hadley v. Baxendale* 156 Eng. Rep. 145 (1854) (contract damages only recoverable if in "contemplation of both parties" at the time of contract formation); *see also Restatement (Second) of Contracts* § 351(1) ("Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach *when the contract was made.*") (emphasis added).

Losses must also satisfy a closely related requirement—they must be proximately caused by the breach. *Hughes*, 271 F.3d at 1066; *see also Nat'l Controls Corp. v. Nat'l Semiconductor Corp.*, 833 F.2d 491, 496 (3d Cir.1987) (noting that lost profits, to be recoverable, must be a "proximate consequence," and not a "merely remote or possible" result of the breach) (internal citations and quotations omitted); *Lewis Jorge Constr. Mgmt, Inc. v. Pomona Unified Sch. Dist.*, 102 P.3d 257, 265 (2004) (holding breach did not "directly or

necessarily cause [contractor's] loss," where contractor alleged breach caused contractor's surety to reduce contractor's "bonding" rating, and that reduction in bonding rating caused loss of other prospective contracts); *Williston* § 64:12.[14] Because these two doctrines are not meaningfully distinct, at least in the context of the case before us, we analyze them under the rubric of foreseeability.

Understanding foreseeability requires a more detailed description of OSC's theories. As we have noted, OSC theorizes that the initial shrinkage of the thrift (the sale of the Citizens/OSBW assets and of the stock of the two subsidiaries) caused damage because the thrift itself was made less profitable (by some $12 million per year), leading to its ultimate demise. OSC argues alternatively and primarily that the breach required OSC to sell its crown jewels in order to infuse additional capital into the thrift and that the sale of the crown jewels caused long-term adverse consequences.

The Court of Federal Claims here did not find that the forced shrinkage of the thrift had a foreseeable relationship to the seizure, indeed concluding that the shrinkage was not "a major issue in determining damages." *Old Stone II*, 63 Fed. Cl. at 85. OSC in its briefs has not called our attention to any testimony that would suggest that the seizure of the thrift by itself was a foreseeable result of the shrinkage. Indeed, the linkage was particularly speculative given the fact that the shrinkage is only alleged to have deprived the thrift of $12 million a year in profits when the total capital deficit at the time of seizure was $77 million. In any event, the foreseeability theory with respect to the sale of the thrift's own assets is subject to the same deficiencies that exist with respect to

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[14] *See Exxon Co., U.S.A. v. Sofec, Inc.*, 517 U.S. 830, 839-40 (1996) ("Although the principles of legal causation sometimes receive labels in contract analysis different from the 'proximate causation' label most frequently employed in tort analysis, these principles nevertheless exist to restrict liability in contract as well").

the primary OSC theory (concerning the forced sale of OSC's own assets) which we now discuss.

We turn then to OSC's primary theory—that the forced sale of the OSC crown jewels had the foreseeable result of bringing about the seizure. Here the Court of Federal Claims did find that the loss was foreseeable both because the capital shortfall as a result of the breach was foreseeable and because "[i]t was also foreseeable that regulators subsequently would demand that [OSC] prop up its failing subsidiary with infusions of capital once [OSB] fell short of its capital requirements." *Old Stone II*, 63 Fed. Cl. at 89-90. In other words the Court of Federal Claims found that the need for additional replacement capital infusions from OSC to the thrift as a result of the breach was foreseeable. But, even if the need for replacement capital was foreseeable, that hardly establishes that the adverse consequences alleged to flow from the need to make infusions were foreseeable. As the Restatement of Contracts explains, "[t]he mere circumstance that some loss was foreseeable, or even that some loss of the same general kind was foreseeable, will not suffice if the loss that *actually occurred* was not foreseeable." *Restatement (Second) of Contracts* § 351 cmt a. (1981) (emphasis added).

For the damages from the sale of the crown jewels to be foreseeable, the parties, at the time of contract formation, would have had to foresee: (1) that the thrift would have other problems that would require additional infusions of regulatory capital; (2) that the crown jewels would be the only source of additional capital because neither the holding company nor the thrift would have access to alternative capital; (3) that the thrift's other problems would be so severe that the thrift would be seized; and (4) that the availability of the crown jewels would have been sufficient to avoid the seizure. OSC has not called our attention to any testimony in the record that will support the foreseeability of any of these assumptions, and we have been unable to locate any. Here

we think that under established principles of foreseeability OSC has completely failed to establish that this extended chain of causation was foreseeable at the time of contract formation.[15]

Our prior *Winstar* cases do not support a contrary conclusion. Some cases have held that the need to replace regulatory capital,[16] or the failure of a thrift due to deficiency in

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[15] The Restatement of Contracts provides an instructive example:

> A, a carrier, contracts with B, a miller, to carry B's broken crankshaft to its manufacturer for repair. B tells A when they make the contract that the crankshaft is part of B's milling machine and that it must be sent at once, but not that the mill is stopped because B has no replacement. Because A delays in carrying the crankshaft, B loses profit during an additional period while the mill is stopped because of the delay. A is not liable for B's loss of profit.
>
> That loss was not foreseeable by A as a probable result of the breach at the time the contract was made because A did not know that the broken crankshaft was necessary for the operation of the mill.

Restatement (Second) of Contracts § 351 cmt a., ill. 1 (1981). As in the illustration, the government did not have reason to know that the replacement capital was necessary to save the thrift from its other problems. *See also id.* at § 351, cmt d. (inability of injured party to make substitute arrangements must be foreseeable).

[16] *See, e.g.*, *LaSalle*, 317 F.3d at 1374 (holding cost of replacement capital is recoverable by thrift and can be measured by dividends paid to issuer of investment capital; remanding for a calculation of cost of replacement capital); *Home Savings*, 399 F.3d at 1353-55 (holding cost of replacement capital is recoverable and can be based on cost of substituting expensive private capital, which counted towards regulatory requirements, for less expensive government-backed deposits, which did not); *see also S. Cal. Fed. Sav. & Loan Ass'n. v. United States* 422 F.3d 1319, 1336-37 (Fed. Cir. 2005) (rejecting government's argument that it was unforeseeable that the loss of regulatory capital forbearances would impact the health of a thrift and thus increase its costs of doing business); *cf. Bluebonnet*, 266 F.3d at 1355-56 (where holding company had agreed—prior to FIRREA—to infuse capital into the thrift, rejecting argument that

regulatory capital,[17] is a foreseeable result of the government's breach of its promise of regulatory forbearance. But today we are allowing the recovery of the replacement capital, and this is not a case in which the thrift was seized because it lacked regulatory capital eliminated by FIRREA. OSC is claiming that the seizure resulted from the fact that the replacement capital was unavailable to resolve other problems not caused by FIRREA.

OSC's foreseeability argument is analogous to a *Winstar* claim for lost profits. In numerous cases we have rejected claims for lost profits on the ground that lost profits are too speculative to be recovered. *See Cal. Fed. Bank v. United States*, 395 F.3d 1263, 1272-73 (Fed. Cir. 2005) ("*Cal Fed II*"); *Glendale*, 239 F.3d at 1380; *Glendale Fed. Bank, FSB v. United States*, 378 F.3d 1308 (Fed. Cir. 2004) ("*Glendale II*"). In *Glendale II*, we observed that

> [G]iven the speculative nature of [a lost profits] claim, one that has yet to be successfully established in any *Winstar* case . . . [and] experience suggests that it is largely a waste of time and effort to attempt to prove such damages.

Glendale II, 378 F.3d at 1313.[18] OSC's claim is even more speculative. A lost profits claim in a *Winstar* case typically

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it was unforeseeable that FIRREA would increase the cost of raising that capital).

[17] *See, e.g., Westfed*, 407 F.3d at 1366-67.

[18] In one case, *Cal Fed*, we required a trial on the issue. There we held that lost profits, based on the theory that FIRREA forced the thrift to sell profitable assets, are not unforeseeable as a matter of law. 245 F.3d at 1349-50. After remand, we affirmed the Court of Federal Claims conclusion that the profits were unforeseeable. *Cal Fed II* at 1272-73; *Cal. Fed. Bank v. United States*, 54 Fed. Cl. 704, 713 (2002). We reasoned that the thrift's lost profits theory was "impractical," and "not susceptible to reasonable proof," and "ha[d] yet to be successfully established in any *Winstar* case." *Cal Fed. II*, 395 F.3d at 1270 (quoting *Glendale II*).

assumes that it was foreseeable the breach would force the plaintiff to sell assets that otherwise would have generated profits and seeks to recover the profits. *See, e.g., Cal Fed.*, 245 F.3d at 1349-50. OSC does not seek to recover lost profits. *See* Pl's Br. at 27 ("OSC did not seek expectancy damages [at trial]"). Nonetheless, OSC's theory does not merely assume that the loss of profits was foreseeable; it also assumes it was foreseeable that those profits (or the revenues from asset sales) would have resolved problems not caused by FIRREA, and that neither OSC nor OSB would be able to resolve those problems by raising funds from other sources. There was no proof that the attenuated claim of causation on which OSC relies was foreseeable.

Accordingly, we hold that the loss of OSC's initial contributions were not a foreseeable result of the enactment of FIRREA and cannot be recovered under a reliance theory. In light of our conclusion we need not address the government's other arguments concerning these restitution and reliance claims.

IV

Finally we note that OSC's restitution claim is barred for another reason. Restitution or reliance damages are inappropriate where relief would result in an "unfair windfall" to the non-breaching party. As we explained in *Bluebonnet*, "the non-breaching party should not be placed in a better position through the award of damages than if there had been no breach." 339 F.3d at 1345; *see also Hansen*, 367 F.3d at 1315 (quoting *Bluebonnet*, 339 F.3d at 1345); *LaSalle*, 317 F.3d at 1371 (noting that "the non-breaching party is [generally] not entitled, through the award of damages, to achieve a position superior to the one it would reasonably have occupied had the breach not occurred."). Here the $74.5 million payments replaced the capital that the breach eliminated, and the award of the additional amounts as restitution or reliance damages would be duplicative.

CONCLUSION

For the foregoing reasons, we affirm the Court of Federal Claims' award of $74.5 million in damages for OSC's post-breach mitigation payments. We reverse the award of $103.2 million in damages for OSC's stock contribution under the RIF assistance agreement. We also reverse the award of $14.8 million in damages for OSC's cash contributions under the Citizens assistance agreement.

REVERSED-IN-PART AND AFFIRMED-IN-PART

COSTS: No costs.

APPENDIX B

UNITED STATES COURT OF FEDERAL CLAIMS

No. 92-647 C

OLD STONE CORPORATION,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

Nov. 18, 2004

OPINION AND ORDER

HODGES, *Judge.*

Plaintiff Old Stone Corporation became a bank holding company in June 1974 pursuant to the Bank Holding Company Act of 1956, 12 U.S.C. §§ 1841-1849. Old Stone Corporation was the sole shareholder of a commercial bank subsidiary, Old Stone Bank. The bank had been organized in Rhode Island as a mutual savings bank in 1819 and operated under that charter until 1974 when it became a commercial bank.

The Federal Home Loan Bank Board approached Old Stone's management in 1984 seeking a buyer for a failing thrift known as Rhode Island Federal Savings Bank.[1] Savings and loan regulators typically guaranteed certain benefits to acquiring investors during this period as consideration for

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[1] The Home Loan Bank Board had approached Old Stone earlier seeking a merger with Rhode Island Federal, but did not offer inducements and plaintiff declined.

their assumption of institutions that had negative net worth. Such incentives included agreements to forbear enforcement of normal regulatory requirements, use of capital credits, and recognition of the negative net worth as "goodwill." The goodwill could be used as regulatory capital to maintain required minimum capital ratios and to leverage loans as if it were tangible capital. The goodwill could be amortized over a period of thirty or forty years as an asset might be.

The savings and loan crisis of the 1980's prompted Congress to enact the Financial Institution Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub.L. No. 101-73, to gain control of problems that it perceived in the savings and loan industry.[2] The new law eliminated or modified a number of investors' contracts with the Government.

This court found that Congress breached the investors' contracts by enacting FIRREA. *Winstar Corp. v. United States*, 21 Cl. Ct. 112 (1990). The Federal Circuit and the Supreme Court agreed. *See Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995) (en banc), *aff'd*, 518 U.S. 839 (1996). The Supreme Court remanded *Winstar*-related cases for consideration of damages. 518 U.S. at 910.

Old Stone Corporation, an investor affected by the breach, filed suit against the United States in 1992. The Federal Deposit Insurance Corporation joined the case as receiver in 1996. Proceedings were delayed by the effects of a pretrial discovery agreement among the Department of Justice and more than 120 plaintiffs with similar actions. Plaintiff's case was assigned to this court last year, and we heard oral arguments on pending cross-motions for summary judgment on liability. We ruled for plaintiff on summary judgment. *Old Stone Corp. v. United States*, No. 92-647C (Fed. Cl.

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[2] See *Hansen Bancorp, Inc. v. United States*, 367 F.3d 1297, 1302-03 (Fed. Cir. 2004), for a concise summary of the circumstances surrounding the passage of FIRREA.

Apr.10, 2003); *see also Old Stone Corp. v. United States*, No. 92-647C (Fed. Cl. Apr.25, 2003) (denying defendant's motion for reconsideration).[3]

Plaintiff filed a motion for partial summary judgment on damages limited to claims that it described as "*Landmark*-style" restitution. *See Landmark Land Co. v. FDIC*, 256 F.3d 1365 (Fed. Cir. 2001). Plaintiff considered the issues in its summary judgment motion to be so similar to those addressed in *Landmark* that it was willing to forgo claims for reliance damages and other theories that would require trial. Restitution does not depend on proof of traditional breach elements such as causation and foreseeability, but it does require a finding of "total breach." *See Hansen Bancorp, Inc. v. United States*, 367 F.3d 1297, 1309-13 (Fed. Cir. 2004) (holding that a finding of total breach may not be appropriate on summary judgment). We denied plaintiff's motion for partial summary judgment on damages and scheduled trial beginning in May 2004. *Old Stone Corp. v. United States*, No. 92-647C (Fed. Cl. Mar.28, 2004). Defendant abandoned its counterclaim against the Federal Deposit Insurance Company, and the FDIC withdrew from the case. The parties filed post-trial briefs concurrently in July and completed their replies in August. Testimony and other evidence presented at trial established that plaintiff is entitled to judgment on its claims.

I. BACKGROUND

Old Stone Bank obtained a charter in the State of Rhode Island as a mutual savings bank in 1819 and operated in that capacity until 1974 when it became a commercial bank. (Tr. at 134.) Old Stone Corporation became a bank holding com-

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[3] We often use descriptive names in this Opinion for the most part to avoid confusion. For example, Old Stone Corporation or "OSC" is the holding company. Old Stone is the commercial bank before the merger, and often simply "the bank" after the merger. Old Stone Bank, or "OSB," is Old Stone Bank, FSB, the merged bank. "RIF" is Rhode Island Federal, the troubled thrift.

pany and the sole shareholder of Old Stone Bank in June 1974. The bank's earnings were good, but management and government regulators were concerned about capital, a "constant worry." (Tr. at 2480.) A 1981 FDIC Report of Examination stated that the bank's capital levels were "inadequate." (Def.'s Ex. 304 at 1-1.) A new law known as Garn-St. Germain offered plaintiff new opportunities.

A. Garn-St. Germain

Congress passed the Garn-St. Germain Depository Institutions Act of 1982, Pub.L. 97-320, to assist the restructuring of the savings and loan industry. This law was designed to make it easier for healthy institutions to acquire troubled thrifts. It included a priority system for the Government to consider offers from potential acquiring institutions. 12 U.S.C. § 1730a(m)(2)(B), *repealed by* FIRREA, Pub.L. No. 101-73, Title IV, § 407. The new law assigned the highest priority to thrift institutions in the same state as a troubled thrift. The next level of priority was a thrift institution in another state. Non-thrift institutions such as banks or bank holding companies in the same state as the troubled thrift were assigned third priority. Last on the list of priorities were out-of-state, non-thrift institutions. Thus, Old Stone had third priority in acquiring a failing thrift in Rhode Island and last priority outside the state.

Plaintiff's counsel explained that some provisions of Garn-St. Germain created "an attractive means of acquiring troubled thrifts . . . ." (Tr. at 129-30.) "[W]e had inquired into the possibility of acquiring troubled thrifts in other states, but that was not too likely until the Garn-St. Germain Act passed, in which case we saw perhaps an opportunity to move out of just our little state into other states where we could grow our business."[4] (*Id.*)

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[4] Old Stone Bank's capital ratio in 1984 was below the 5.5% minimum required by the Federal Deposit Insurance Corporation. The FDIC was

Plaintiff's counsel stated that obtaining the transfer of a major institution like Old Stone to the savings and loan insurance fund was "a feather in FSLIC's cap." (Tr. at 3156.) Old Stone and Old Stone Bank were prepared to pay more than a million dollars per year in premiums to FSLIC, counsel stated. (*Id.*) One of defendant's experts testified that the premiums were $1.5 million per year. (Tr. at 1493.)

Old Stone was on FSLIC's "premier priority acquirer list" according to plaintiff. (Tr. at 3157.) Government regulators were very concerned about the health of the insurance fund and the consequences of widespread thrift failures. Plaintiff noted that "had FSLIC ever defaulted, it would be a calamity of [great] magnitude . . . [s]o FSLIC was very, very eager that these transactions take place." (Tr. at 3158-59.) FSLIC put Old Stone on the preferred list to encourage Old Stone to acquire thrifts, to make additional acquisitions, to raise substantial capital, and to expand. (Tr. at 2489.)

Mr. Major, Old Stone Corporation's general counsel, testified that mutual savings banks generally were limited to the New England area and to the Northwest. (Tr. at 133.) He explained that the savings bank structure permitted "a mix of assets, mostly real estate loans, but also some commercial loans, so that we had had some experience up through the years with commercial loans while we were a mutual savings bank." (Tr. at 133-34.) For this reason, the bank was interested in obtaining a federal savings bank charter. Federal

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the insurer and regulator of Old Stone Bank at the time. However, a regulator testified that Old Stone Bank was in capital compliance with FSLIC and FHLBB after the merger in 1984. An OTS examination in 1988 yielded a composite score of 2. (Def.'s Ex. 429 at 2.) See *infra* note 11 for an explanation of the composite scoring system. Old Stone had total resources of $1,854,468,000 and total deposits of $1,067,321,000 when the transaction occurred. (Def.'s Ex. 18 at 3.) Rhode Island Federal had total resources of $138,633,000 and total deposits of $111,444,000. (*Id.*)

savings banks were a relatively new type of institution at the time. The federal savings bank "was different from a traditional savings and loan because it did allow for commercial lending, business lending powers, which is something that savings and loan associations traditionally did not have." (Tr. at 134.)

Mr. Rosati was the president and chief executive officer of Old Stone Corporation. He stressed the greater "flexibility" of the thrift holding company structure that would accompany a federal savings bank charter (Tr. at 142-43) and the opportunity to expand Old Stone's business into other financial services areas (Tr. at 137). Old Stone Corporation felt that it could accomplish both goals when FSLIC and the Federal Home Loan Bank Board began looking for investors that were interested in acquiring troubled or failing thrifts.

Old Stone was the second-largest financial institution in Rhode Island at the time. (Tr. at 129-30.) Mr. Major commented that as a result, "there wasn't much room to grow." (Tr. at 129) "[Old Stone] couldn't acquire other . . . institutions because of antitrust considerations[, and] . . . couldn't grow into other states because there were interstate banking laws at that time . . . . [The bank was] looking for ways to grow [its] deposit franchise in other states and the banking laws traditionally had not allowed that." (Tr. at 130.) Old Stone had another consideration for its interest in the deal.

> We had three regulators before[:] the Federal Reserve for the holding company, the FDIC for the bank and also the state of Rhode Island because we were state chartered. And instead we would have one regulator, the Federal Home Loan Bank system. It would allow for the expansion into other businesses that we might think appropriate and provide us more flexibility with the regulatory framework because we didn't have those three different regulators to have to account to regularly.

(Tr. at 141-42.)

The Federal Savings and Loan Insurance Corporation and the Federal Home Loan Bank Board were looking for investors in the failing thrifts. "Old Stone was familiar with that kind of institution and it seemed like the perfect mix for us, this new federal savings bank charter[,] so we were very interested." (Tr. at 134.) FSLIC offered a failing thrift known as Rhode Island Federal to plaintiff in 1983. (*Id.*) Old Stone conducted a due diligence exam, but declined to bid on Rhode Island Federal because the regulators did not offer financial assistance or regulatory capital forbearances. (Tr. at 146-47.) Later, regulators approached Old Stone with offers of financial assistance, forbearances, and waivers. This renewed Old Stone's interest in obtaining Rhode Island Federal. According to Mr. Major, the bid package FSLIC was offering

> not only provided for financial assistance, cash assistance to help fill up the negative net worth of the institution but also would allow capital treatment, regulatory capital treatment for the capital that would be infused, would be allowed regulatory accounting treatment as a capital credit, . . . and if supervisory goodwill were created as a result of the acquisition, that it would be able to be amortized or written off over a long period of time.

(Tr. at 147.) Such merger incentives were part of a regulatory scheme called the Phoenix Program.

Government regulators devised and implemented the Phoenix Program in an attempt to sustain the savings and loan industry and to avoid exhaustion of the FSLIC insurance fund. *See, e.g.*, *LaSalle Talman Bank, FSB v. United States*, 317 F.3d 1363, 1366-68 (Fed. Cir. 2003). The intent of the Program was to consolidate

> failing or failed thrifts into . . . association[s] that would . . . achieve efficiencies and receive close regulatory

> oversight . . . [and] also receive significant [government] assistance . . . . [Program] assistance included direct monetary contributions [and] regulatory forbearances. [Regulators also authorized the use of] a purchase accounting system whereby assets and liabilities [of the troubled thrift] would be revalued at market price . . . . [T]he ensuing net liability would be recorded as an asset called "supervisory goodwill" and accorded an extended amortization term.

Id. at 1367. The regulators' offer of these incentives to Old Stone was memorialized in the Assistance Agreement (Pl.'s Ex. 135).

B. The Assistance Agreement

Old Stone Corporation attorneys negotiated the terms and conditions by which plaintiff would acquire Rhode Island Federal during a period of more than a month. (Tr. at 173-79.) The resulting Assistance Agreement incorporated a Stock Acquisition Agreement, a Forbearance Letter, and the Net Worth Maintenance Stipulation.

The Assistance Agreement directed Rhode Island Federal to form a first-tier service corporation called Newco. Rhode Island Federal would transfer cash to Newco in exchange for Newco's stock. Old Stone Corporation, the holding company, would transfer the stock of Old Stone Bank to Newco as a "contribution of capital." (Pl.'s Ex. 135 at 2, § 2(4) at 4.) Newco then would direct Old Stone Bank to distribute its assets and liabilities, except certain trust assets, to Rhode Island Federal. Finally, Rhode Island Federal would change its name to Old Stone Bank, FSB.[5]

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[5] One result of the transaction was the conversion of the failing thrift, Rhode Island Federal, from a federal mutual savings and loan to a federal stock savings bank. The Federal Home Loan Bank Board was authorized to convert a mutual institution into a stock institution or into a federal stock savings bank in certain circumstances. For example, it could permit

Bank attorneys sent a letter to the Government the following month setting out other aspects of the transaction to which negotiators had agreed. (Pl.'s Ex. 74.) Old Stone Bank would remain in existence as a second-tier subsidiary of Old Stone Bank, FSB and operate as a trust company. Newco would remain a first-tier service corporation. Plaintiff also sent a letter to the Government in July 1984 requesting additional forbearances and waivers. (Pl.'s Ex. 45.) Among them were (1) the use of push-down accounting to record the purchase of Old Stone Bank, FSB's capital stock, (2) treatment by FSLIC of its cash contribution as a credit to OSB's net worth, and (3) amortization of intangible asset value according to the straight-line method over a thirty-year period.

FSLIC agreed to contribute $9.55 million cash to the thrift. Regulators would permit the resulting thrift, Old Stone Bank, FSB, to operate immediately. Furthermore, FSLIC would indemnify the bank from losses and expenses for liabilities not listed at closing on the balance sheet of Rhode Island Federal. It also would defend the bank from actions challenging FSLIC's authority to approve the transaction or the authority of the holding company, the bank, or Rhode Island Federal to consummate the transaction.

In August 1984 FHLBB made findings approving the supervisory conversion of Rhode Island Federal. (Def.'s Ex. 15.) Old Stone sought consent from FDIC in September 1984 to transfer assets to Rhode Island Federal in consideration of Rhode Island Federal's assumption of the bank's deposit liabilities:

> Old Stone Bank . . . with total resources of $1,854,468,000 and total IPC deposits of $1,067,321,000,

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such a conversion "if the Director has determined that severe financial conditions exist which threaten the stability of an association and that such authorization is likely to improve the financial condition of the association . . .." 12 U.S.C. § 1464(p)(2)(A).

> has applied, pursuant to Section 18(c)(1)(C) of the Federal Deposit Insurance Act, for the Corporation's consent to transfer certain assets to Rhode Island Federal Savings and Loan Association . . . with total resources of $138,633,000 and total IPC deposits of $111,444,000 . . . in consideration of the assumption of the liability to pay deposits made in Old Stone Bank.

(Def.'s Ex. 18 at 3.) The FDIC expedited the application by waiving publication of notice and authorizing immediate consummation of the transaction. (*Id.* at 2.) The FDIC did this because it wanted "to prevent the probable failure" of a federal institution. (*Id.* at 1.) The FDIC issued an approval letter on September 17, 1984, conditioned upon the bank's "attainment of a minimum capital/assets ratio by December 31, 1985." (*Id.*) The FDIC added the following regarding the Federal Home Loan Bank Board: "The [FDIC's] Board of Directors in deciding to approve this application did so with the understanding that [FHLBB's] Board of Directors would amend its approval Resolution to contain an identical minimum capital requirement." (*Id.*) An October 19, 1984 letter from the Federal Home Loan Bank Board to the president of Old Stone Bank at the time, Joseph F. Murphy, stated that the Board's $9.5 million contribution to Rhode Island would be "a credit to the FSB's net worth; therefore, for regulatory accounting purposes, the FSB may book such contribution as a direct addition to its net worth." (Def.'s Ex. 23 at 4.) Thus, Old Stone Corporation became a thrift holding company owning 100% of the shares of Old Stone Bank, FSB. Old Stone Bank, FSB had two subsidiaries—Newco, the service corporation, and Old Stone Bank, then a trust company.

C. The Breach

Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act in 1989 as part of an extensive

overhaul of the savings and loan industry.[6] Pub.L. No. 101-73. FIRREA banned many of the inducements offered by the regulators through the Phoenix Program and tightened liquidity requirements.[7] Some of these inducements were similar to those offered in connection with the supervisory mergers of Rhode Island Federal and of Citizens Federal. *See Winstar*, 518 U.S. at 847-48.

The Federal Circuit summarized the action by Congress and its effect, in part, as follows:

> Despite the superficial appeal of supervisory mergers, these arrangements could not rescue the industry and the FSLIC from a worsening crisis. In 1989, Congress intervened by enacting FIRREA. As part of an extensive reformation of the savings and loan industry, FIRREA mandated minimum capital requirements and prohibited the use of supervisory goodwill. No longer able to rely on supervisory goodwill, many thrifts could not comply with FIRREA's capital requirements and were seized by regulators.

Hansen, 367 F.3d at 1303 (citation omitted). The Government's breach eliminated capital credits from Old Stone Bank's regulatory capital. The regulators required Old Stone Corporation to compensate for the difference by enforcing the

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[6] *See, e.g., Winstar*, 518 U.S. at 845 (noting that 435 savings and loans failed during 1981-1983). The Government's estimated cost to pay depositors was $15.8 billion in 1985. *Id.* at 847.

[7] For example, FIRREA imposed new minimum capital requirements that typically were contrary to assistance agreements that bank regulators had issued to investors. These included: (1) tangible capital equal to at least 1.5% of assets; (2) core capital equal to at least 3% of assets; and (3) risk-based capital requirements related to risk-weighted balance of total assets. *See* 12 U.S.C. §§ 1464(t)(2)(A)-(C); 12 C.F.R. § 567. Minimum, adequate core capital increased to 4% effective December 1, 1992. *See* Federal Deposit Insurance Corporation Improvement Act of 1991, Pub.L. No. 102-242.

Net Worth Maintenance Stipulation. Regulatory approval of the holding company's proposed Capital Plan after breach was dependent on plaintiff's compliance with the Net Worth Maintenance Stipulation.

Mr. Rosati, Old Stone Corporation's chief executive officer at the time, testified that the bank lost $80 million in capital as a result of Congress' enactment of FIRREA and the resulting loss of goodwill as regulatory capital. (Tr. at 2361.) Regulatory capital was a cushion that the bank depended on heavily, he noted (Tr. at 2368-71); it accounted for forty percent of the bank's capital (Tr. at 2370). The bank replaced this capital in part by selling subsidiaries. Mr. Rosati stated that it was not a good time to sell, and the fire-sale circumstances exacerbated the problem. (Tr. at 2362-63.) Old Stone Corporation could have sold the subsidiaries for more had it waited, but the regulators gave it no choice. (Tr. at 2363-64.)

Moreover, the earnings from the sale of subsidiaries could not be redeployed. (Tr. at 2363.) The bank could not put the earnings into other earning assets as banks normally do because of the need to shrink the bank and to raise capital.[8] (Tr. at 2363.) Regulators told Mr. Rosati that the holding company was obligated to meet the requirements of the Net Worth Maintenance Stipulation, even though the Government had breached the Assistance Agreement to which it was a party.[9]

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[8] Old Stone Bank had sold OSCal, the bank's California lending unit, in December 1989 to raise capital, and it had sold Old Stone Bank of Washington in May 1990 in a similar effort to improve its capital position. It made a $9.2 million profit on the sale. (Tr. at 740, 826, 916.)

[9] They backed up such directives with the threat of cease and desist orders and civil penalties, though Mr. Peckham, a testified that he had seen only one case of civil penalties in his years as a regulator. (Tr. at 1017-19.) That was an egregious case involving "a lengthy criminal proceeding," he said. (Tr. at 1019.)

Old Stone's management conducted a "strategic review" concluding in September 1989. (Pl.'s Ex. 360 at 16.) The Office of Thrift Supervision required Old Stone to prepare a Capital Plan, which it approved in March 1990. Plaintiff's Capital Plan set out its strategy to deal with asset quality issues and to satisfy the regulators' demands for improved capital ratios. Management stated in the Capital Plan that it would "address asset quality issues with increased reserves and writedowns where necessary." (*Id.*) "Since the asset quality measures would be detrimental to the capital objectives, management will divest of several subsidiaries to restore capital accounts and to focus its capital resources on the Rhode Island operation." (*Id.*)

The Capital Plan also included the following:

> [T]o reduce credit risk as well as to meet FIRREA guidelines relating to non-residential real estate assets, Old Stone has largely discontinued its commercial real estate lending operations . . . and sold its California residential construction lending unit. The assets produced by these divisions have been among the highest yielding in the Bank's portfolio with substantial fee generation as well. The winddown of expenses related to these activities will occur throughout 1990 but not as rapidly as the income reduction.

(*Id.* at 17-18.) Old Stone's Capital Plan also represented to the regulators that management would "mitigate the capital reduction [by] . . . mov[ing] quickly to sell certain subsidiaries and divisions . . . ." (*Id.* at 18.) These efforts to raise capital included (1) sale of the bank's California lending unit known as OSCal in December 1989; (2) sale of the bank's tuition-budgeting company for a $22 million gain in December; and (3) an agreement to sell the Seattle, Washington-based thrift that was a division of Old Stone Bank, FSB in 1989. (*Id.*)

The Office of Thrift Supervision approved the bank's Capital Plan conditioned on Old Stone Corporation's agreement that it would maintain the bank's capital position pursuant to the Net Worth Maintenance Stipulation. The holding company contributed a total of $74.5 million of additional capital to the bank from 1990 through 1992.[10] Management reported that it had reached the Capital Plan goals submitted in 1990. Despite these efforts, the bank had fallen out of compliance at the 1991 examination by the regulators. The next step was the Capital Directive.

The bank described the Capital Directive as "a regulatory order which governs the activities of the bank." (Tr. at 362.) "It limits the kinds of assets that the bank can invest in." (Tr. at 362.) "It limits the growth of the bank and it directs that certain actions be taken to improve the capital position of the bank." (Tr. at 362.) Plaintiff's general counsel, Mr. Major, testified that

> [the] directive did not allow any growth whatsoever. It required continued shrinkage. Before, under the capital plan, we at least were able to grow by the amount of interest credited to our deposit accounts, but this did not even permit that form of growth. So we had to just continually shrink the bank, sell assets, not redeploy any payments that were received but, rather, use those to pay off liabilities so that the ratio, we would come into compliance with a ratio by shrinking the size of the denominator of that fraction.

(Tr. at 363-64.)

Congress phased out the bank's contract right to count goodwill as tangible capital after December 31, 1989 with the enactment of FIRREA. Other capital ratios were affected as well. *See* 12 U.S.C. §§ 1464(t)(2)(A)-(C), 12 C.F.R. § 567.

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[10] The holding company downstreamed additional capital of $45,463,000 in 1990; $27,500 in 1991; and $1,600,000 in 1992. (Tr. at 315.)

Bank examiners reported to OSB's Board of Directors on June 22, 1990 that the bank's condition was unsatisfactory. (Pl.'s Ex. 380 at 1.) Regulators had assigned a composite rating of 4 to the bank after its examination.[11]

> Your institution's serious asset quality problems are the major factor contributing to this overall unfavorable assessment. The institution's poor earnings performance and its failure to meet its risk-based capital requirement result directly from asset quality deterioration. Your institution is dependent upon its parent holding company to provide sufficient infusion of capital in the near term.

(*Id.*)

D. Shrinking the Bank

The bank found it necessary to shrink after the breach to meet required capital ratios. The capital ratio is a relationship between capital and assets. A bank may improve its capital ratio either by increasing capital—often a difficult goal to accomplish in the circumstances—or shrinking the bank's assets. That is, sell assets that often serve as the bank's primary source of earnings. Either strategy creates a higher capital ratio. As banks sell their best assets to raise capital, however, their income drops dramatically.

Testimony and other evidence presented in this case does not show why regulatory agencies found this to be a useful approach to the problem. Not only did banks lose income-

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[11] CAMEL ratings are used by regulators to provide an assessment of a financial institution's condition and operations in the areas of Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity. A composite rating, or "CAMEL rating," of 4 means that the bank is relatively unsound. The ratings range from 1 to 5, with the higher numbers being the more unsound. Composite ratings are comprised of the ratings for each of the areas listed. The terms "composite CAMEL rating" and "CAMEL composite rating" also are used in examination reports by bank regulators. The bank's CAMEL rating in 1984 was 2.

producing assets, but also they missed potentially valuable opportunities to grow and prosper. For example, Old Stone had intended to acquire Home Savings of North Carolina. It entered into negotiations with Home Savings but cancelled the transaction because management decided that it must concentrate on meeting FIRREA's capital requirements instead of acquiring another institution. Mr. Major testified,

> one of the ways that we were being called upon to come into compliance was for the holding company to contribute capital pursuant to the net worth maintenance [stipulation] to Old Stone Bank[, FSB]. And Old Stone of North Carolina was a very profitable company, very attractive market, and the sale of that company would have been able to generate lots of cash, that then would have, we would have been able to infuse into Old Stone Bank[, FSB] to meet capital shortfall.

(Tr. at 312.)

Mr. Rosati testified that shrinkage caused the bank to lose its "three crown jewels." (Tr. at 2379.) These were Old Stone Credit Corporation, which was earning approximately $36 million per year,[12] Old Stone of North Carolina, with $6

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[12] At another point Mr. Rosati testified that the Credit Corporation earned $28 million; he may have been talking about totals:

> Old Stone Credit Corporation was a very solid earning and growing company . . . . [S]imilarly to what happened in the bank by selling the assets of the corporation under the net worth maintenance [stipulation] . . . we did and were forced to do several things. By selling them we lost the continuing earnings stream that was $28 million, and we had every reason to believe that those earnings would have continued. I think that there would have been years of increase, maybe years of a little flat growth, but they were good, solid earning companies. We were not able to redeploy funds, because we had to pay down liabilities. We did put $20 million into the bank as part of this transaction.

(Tr. at 2380.)

million in annual earnings, and Old Stone California (OSCal), which was earning one to two million dollars. (Tr. at 2379.) "So that's approximately $38 million of continuing earnings," he stated.[13] (Tr. at 2379.)

OSCal, a tuition financing company, was sold in 1989. Sale of OSCal and Academic Management Services raised $22 million in new capital. The bank could not reinvest the proceeds in income-generating assets but paid down liabilities and increased its capital reserves to improve its capital/assets ratio. OSCal and Academic Management Services had been generating $7 million in annual earnings. Plaintiff sold Old Stone Bank of Washington in May 1990. That branch had been producing $5 million a year in earnings.[14]

Asset quality continued to deteriorate. Old Stone Bank filed a Revised Capital Plan on December 1991. The bank submitted another Revised Capital Plan in October 1992, but later in the year the bank fell below all three regulatory capital requirements. Management officials testified convinc-

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[13] Defendant cited Mr. Rosati's testimony that the Rhode Island Federal transaction "did not involve a large amount of capital and . . . standing alone, OSC never would have signed the net worth maintenance [stipulation] for RIF." (Def.'s Post-Trial Reply Br. at 3 (citing Tr. at 2487-89).) Asked why he agreed to the transaction, he stated "I did it for one reason, so it would make additional acquisitions . . . raise substantial capital and to expand." (Tr. at 2489.) Asked if such additional acquisitions were made, he said,

> [y]es, in 1985 Old Stone acquired Citizens. As a result I believe additional regulatory capital of approximately $74 million came with that transaction, so it was significant at that point. Aggregating that with Rhode Island Federal, I believe the total number was in the neighborhood of 90, 94 million dollars.

(Tr. at 2489.)

[14] Defendant argues that plaintiff would have sold its Washington branch anyway, and in fact tried to do so several times before the breach—but if so, this evidence is not meaningful legally.

ingly that the bank could have been saved had regulators been willing to give them more time to conclude a proposed agreement by which outside investors would have put new capital into the bank.[15] Regulators testified that they had heard many such proposals and that many deadlines had passed. They felt that they had to cut off the process at some point. The regulators were not in full agreement concerning the need to close the bank when they did. Plaintiff filed this lawsuit in 1992. The Government seized Old Stone Bank on January 29, 1993.

The issue is not whether the Office of Thrift Supervision acted wisely or appropriately in closing the bank. The issue is the proper remedies to apply in calculating damages. Plaintiff argued that it is entitled to reliance damages, restitution, and costs of mitigation.

II. DAMAGES

The Financial Institution Reform, Recovery, and Enforcement Act eliminated or modified many of the promises that FSLIC had made to Old Stone Corporation in connection with its acquisition and conversion of Rhode Island Federal. *See Winstar*, 518 U.S. at 856-58. The Supreme Court found that FIRREA effectively breached the promises that the Government had made to investors who had agreed to take over failing thrifts. *Id.* at 870.

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[15] Lead counsel for the Government commented,

> [Management] made efforts. They cooperated. And they tried to make a go of it. I don't think the evidence would suggest otherwise. But what the evidence, the unrefuted evidence supports is that it didn't work. It simply didn't work. And . . . regardless of their best intentions, they couldn't pull it out. . . . I agree that the regulators thought very highly of them. Mr. Gridley testified he thought very highly of Mr. Rosati. But he couldn't get it done.

(Tr. at 3225.) In fact, we think management could have "pulled it out."

"When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." *Lynch v. United States*, 292 U.S. 571, 579 (1934). The contract remedies to which the Government becomes subject in this case are reliance and mitigation damages, and restitution, and mitigation. Plaintiff may seek compensation for losses sustained or it can demand that defendant return its money. The former remedy permits compensation for losses, typically reliance or mitigation damages; the latter is restitution, primarily a demand for disgorgement. Old Stone is not seeking expectancy damages.

Applying standard breach damage theories to "the complex fact patterns of these cases" has been a challenge both to trial courts and to attorneys who present such theories. *Glendale Fed. Bank, FSB v. United States*, 378 F.3d 1308, 1312 (Fed. Cir. 2004). Two issues complicate this further. The Court of Appeals for the Federal Circuit has expressed concern about the possibility of creating a "windfall" for the non-breaching party in awarding damages. *Hansen*, 367 F.3d at 1315 (noting that restitution is inappropriate "where relief would result in an 'unfair windfall' to the non-breaching party"). Yet, "'[i]f a reasonable probability of damage can be clearly established, uncertainty as to the amount will not preclude recovery,' and the court's duty is to 'make a fair and reasonable approximation of damages.'" *Bluebonnet Sav. Bank, FSB v. United States*, 266 F.3d 1348, 1356-57 (Fed. Cir. 2001) (quoting *Locke v. United States*, 151 Ct. Cl. 262, 267, 283 F.2d 521, 524 (1960)). That is, damages must be fair. Uncertainty as to amount is not a bar.

Reliance damages are traditional contract damages. The Federal Circuit has urged litigants and trial judges to avoid doctrinal disputes regarding damage theories in these cases and to return non-breaching parties to their rightful conditions. *See Glendale*, 378 F.3d at 1313 ("We remain optimis-

tic that with the additional guidance and support given the trial court . . . the remainder of the Winstar cases can be disposed of . . . based on the particular facts of the case, and without further dispute over the theory on which damages may be calculated."). The courts are thus directed to de-emphasize theories of recovery and focus on the status of the parties. *Id.*

We ruled in *Landmark Land Co. v. United States* that the investors' contribution pursuant to an assistance agreement could be returned either as restitution or as reliance damages. 46 Fed. Cl. 261, 278 (2000), *aff'd in part, rev'd in part, vacated in part sub nom. Landmark Land Co. v. FDIC*, 256 F.3d 1365 (Fed. Cir. 2001). As restitution, the court would return or "disgorge" the benefit that defendant obtained from plaintiff's participation in the agreement. *Id.* Reliance damages would equal the amount that plaintiff contributed in accordance with the terms of the contract that defendant breached. *Id.* Restitution was a fair and reasonable approximation of plaintiff's damages in that case. As it happened, the two theories produced the same award to Landmark.

Reliance damages assume a valid contract, while restitution assumes that the contract is void and without effect. A plaintiff seeking reliance damages must show that: (1) its losses were reasonably foreseeable at the time of the contract; (2) the breach was a substantial factor in causing its losses; and (3) it has proven its losses with reasonable certainty. *See Bluebonnet Sav. Bank, FSB v. United States*, 47 Fed. Cl. 156, 167 (2000), *rev'd on other grounds*, 266 F.3d 1348 (Fed. Cir. 2001); *see also Restatement (Second) of Contracts* §§ 344(b), 351-52 (1981).

Awarding damages according to a restitution analysis can require consideration of whether the breach was "total," whether it could create a "windfall," and whether the non-breaching party waived its rights by continued performance. According to most authorities, the main purpose of restitution

is to prevent unjust enrichment of the breaching party. *See Restatement (Second) of Contracts* § 344 cmt. a (1981). It is not a damage remedy. *See* Dan B. Dobbs, *Law of Remedies: Damages, Equity, Restitution* § 4.1(1) (2d ed.1993).

"Money-back restitution" is the remedy discussed in *Mobil Oil Exploration & Producing Southeast, Inc. v. United States*, 530 U.S. 604, 608 (2000), *Landmark*, 256 F.3d at 1372-73, and *Hansen*, 53 Fed. Cl. at 101. Restitution in the *Winstar* context arises where the non-breaching party made an initial investment in the thrift according to a requirement of the contract. The Federal Circuit has "allowed restitution for the limited purpose of returning the acquiring thrift to the status quo ante when *specific initial contributions* to an acquired thrift have been established." *Glendale*, 378 F.3d at 1313 (citing *Landmark*, 256 F.3d at 1373-74) (emphasis added).

Parties claiming restitution may find that they have waived that remedy by continuing to perform under the contract after the breach. *Mobil Oil*, 530 U.S. at 622. Reliance damages are available for costs incurred before and after the breach. Old Stone incurred a large portion of its alleged damages after the breach. The standard for reliance damages is not whether the expenditures were required under the contract, but whether the expenditures were made in reliance upon the contract. For restitution, plaintiff would have to show that the contract required an expenditure; for reliance, that it spent the money because of the contract. *Landmark* 256 F.3d at 1379; *Restatement (Second) of Contracts* § 344 (1981).

Returning the parties to the situation in which they found themselves pre-contract may require more than return of the benefits conferred on the breaching party. *See Landmark*, 256 F.3d at 1372. Another measure may be "the *cost* of the plaintiff's performance, which includes both the value of the benefits provided to the defendant and the plaintiff's other costs incurred as a result of its performance under the contract." *Id.*, at 1372. Perhaps concerned that such "other costs

incurred" may confuse restitution with reliance damages, the appeals court explained that while the "two approaches to restitution are not necessarily incompatible, we have observed that the 'costs' measurement may sometimes be more properly viewed as a form of reliance damages." *Hansen*, 367 F.3d at 1314 n. 13 (citing *LaSalle*, 317 F.3d at 1376 (citing *Acme Process Equip. Co. v. United States*, 171 Ct. Cl. 324, 359, 347 F.2d 509, 530 (1965), *rev'd on other grounds*, 385 U.S. 138 (1966)) ("When restitution damages are based on recovery of the expenditures of the non-breaching party in performance of the contract, the award can be viewed as a form of reliance damages, wherein the non-breaching party is restored to its pre-contract position by returning [to it] as damages the costs incurred in reliance on the contract.")).

The Federal Circuit noted that the "problem with which the trial court has had to wrestle has been finding a viable damages theory that fits the complex fact patterns of these cases, one that is fair to the damaged thrifts, but is based on real losses sustained so as not to overcompensate for the breach."[16] *Glendale*, 378 F.3d at 1312. We discuss restitution in additional detail below, but the Circuit's direction that the court prefer reliance as a remedy controls the overall analysis. "'Reliance is an ideal recovery in Winstar cases.'" *Glendale*, 378 F.3d at 1313 (quoting Jon W. Burd, *Where The Rabbit Hole Ends: A Working Model For Measuring Winstar-Type Damages In The Federal Circuit*, 13 Fed. Cir. B.J. 657, 685 (2004)). "Despite the landscape where alternative forms of recovery are speculative and loss models inherently unreli-

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[16] This has been a common complaint among trial judges handling the *Winstar* line of cases. For example, the trial court in *Hansen* commented, "the *Winstar* litigation suffers from the lack of any template." 53 Fed. Cl. at 108. "The result is that common issues must be relitigated in each case. Moreover, the numerous decisions on summary judgment have led to piecemeal decisions on, for example, the proper measure of damages . . . ." *Id.*

able, reliance damages can be ascertainable and fixed." *Id.* We proceed with a discussion of restitution, reliance, and mitigation as applied to the facts of this case, in light of these recent expressions of the appeals court's desired approach to resolving these cases.

A. Restitution

The following issues arise in connection with restitution in this case: (1) did the contributions result from a legal obligation; (2) did the Government commit a "total breach;" (3) would an award to plaintiff result in a "windfall;" (4) did the Government receive a benefit that the law of restitution requires it to disgorge; and (5) were the goods "substantially altered" during performance.

Restitution is available in limited situations. "[W]e have allowed restitution for the limited purpose of returning the acquiring thrift to the status quo ante when specific initial contributions to an acquired thrift have been established." *Glendale*, 378 F.3d at 1313 (citing *Landmark*, 256 F.3d 1365 (Fed. Cir. 2001)).[17] The Federal Circuit has suggested that restitution should be awarded in these cases cautiously. *See id.* at 1313, 1315. Restitution should restore the non-breaching party to its pre-contract status, not to its pre-breach status. *See Landmark* 256 F.3d at 1372 (citing *Glendale*, 239 F.3d at 1380). The damages awarded must be determinable and capable of being calculated reasonably, and they may not

[17] The trial court in *Landmark* drew a distinction between the initial contribution required by the contract and a later contribution that the contract did not require. *See Landmark Land Co. v. United States*, 46 Fed. Cl. 261, 267 n. 7 (2000), *aff'd in part, rev'd in part, vacated in part sub nom. Landmark Land Co. v. FDIC*, 256 F.3d 1365 (Fed. Cir. 2001). The plaintiff acted voluntarily in the latter instance and did not qualify for restitution for that reason. This was an unusual fact situation. *See Glendale*, 378 F.3d at 1313. The Federal Circuit suggests that *Landmark* is limited to its facts. The appeals court encourages attorneys and trial judges to focus on reliance as a remedy. *See id.* at 1312-13.

exceed an amount that would result in a windfall. The breaching party is entitled to an offset measured by the value of the benefit it has conferred on the non-breaching party, if applicable. *See Restatement (Second) of Contracts* § 374(1) (1981).

Defendant argued that the Assistance Agreement did not require that plaintiff contribute all of the holding company's stock in Old Stone to Rhode Island Federal. A party seeking restitution must show that its costs arose from requirements of the contract breached. "[P]laintiff's contribution must have been made in performance of its contractual obligations." *Landmark*, 256 F.3d at 1375. Plaintiff claims that this argument is based on semantics—an interpretation of the contract that is unwarranted and prohibited by explicit terms of the contract itself.

Defendant questioned whether the Government committed a "total breach" of contract by enacting FIRREA. "[R]estitution is 'available only if the breach gives rise to a claim for damages for total breach and not . . . partial breach.'" *Hansen v. United States*, 367 F.3d at 1309 (quoting *Restatement (Second) of Contracts* § 373 cmt. a. (1981)).

> Not every departure from the literal terms of a contract is sufficient to be deemed a material breach of a contract requirement, thereby allowing the nonbreaching party to cease its performance and seek appropriate remedy. The standard of materiality for the purposes of deciding whether a contract was breached "is necessarily imprecise and flexible." The determination depends on the nature and effect of the violation in light of how the particular contract was viewed, bargained for, entered into, and performed by the parties.

Stone Forest Indus., Inc. v. United States, 973 F.2d 1548, 1550-51 (Fed. Cir. 1992) (quoting *Restatement (Second) of Contracts* § 241 cmt. a and citing cmts. a & b (1981)); *see*

also Restatement (Second) of Contracts § 243 cmt. e (1981) (Determination of total breach is made "in the light of all the circumstances, taking account of the difficulty of calculating damages for total breach and of any uncertainties that could be avoided if the injured party were given a claim merely for damages for partial breach.").

Plaintiff's witnesses testified that obtaining additional regulatory capital was highly important to the transaction. (*See, e.g.*, Tr. at 148, 271, 733.) Counsel stated that the forbearances on the other hand "were not really of great economic consequence." (Tr. at 739.) Defendant challenges the credibility of plaintiff's witnesses on this point.

Restitution is not appropriate "where relief would result in an 'unfair windfall' to the non-breaching party." *Hansen*, 367 F.3d at 1315 (quoting *Restatement (Second) of Contracts* § 384 cmt. a (1981)). The appeals court suggested in *Hansen* that restitution damages should be awarded cautiously, to restore the non-breaching party to its pre-contract status and nothing more. *Id.* The damages awarded must not exceed a range that would create a windfall for the non-breaching party. Such a result would not return the non-breaching party to its pre-breach position, but to a better position. This would be a windfall.[18] "[T]he non-breaching party should not be placed in a better position through the award of damages than if there had been no breach." *Id.* (quoting *Bluebonnet*, 339 F.3d at 1345). The *Hansen* decision does not provide a means to measure damages vis-a-vis potential windfalls.

The *Restatement* does not mention the windfall issue specifically. The court in *Coast-To-Coast Financial Corp. v.*

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[18] Windfall is "an unexpected piece of good fortune." William Morris & Mary Morris, *Morris Dictionary of Word and Phrase Origins* 605 (1977). The phrase "[dates back] to medieval England, when commoners were forbidden to chop down trees for fuel. . . . [I]f a strong wind broke off branches or blew down trees, the debris was [considered to be] a lucky and legitimate find." *Id.*

United States, 60 Fed. Cl. 707, 711-12 n. 9 (2004), *amended by* 62 Fed. Cl. 469 (2004) (denying plaintiff's motion for reconsideration), offered some discussion of windfall, but noted that the majority in *Mobil Oil* did not seem concerned with a potential windfall for the oil companies in that case. In *Citizens Federal Bank, FSB v. United States*, the court suggests that windfall is an "unjust enrichment" as described in the *Restatement (Second) of Contracts*. *See* 59 Fed. Cl. 507, 524 (2004) ("[T]he reason post-judgment damages are discounted is so that damages accrued after the date of judgment would not result in a windfall or 'unjust enrichment' for plaintiffs.").

"When one party to a contract repudiates that contract, the other party 'is entitled to restitution for any benefit that he has conferred on the repudiating party by way of part performance or reliance.'" *Mobil Oil*, 530 U.S. at 608 (citing *Restatement (Second) of Contracts* § 373 (1981)). Restitution is a party's "interest in having restored to him any benefit that he has conferred on the other party." *Restatement (Second) of Contracts* § 344(c) (1981). The comment following this definition explains that courts will grant restitution to prevent unjust enrichment. *Id.* at § 344 cmt. a. "Restitution is, therefore, available to a party only to the extent that he has conferred a benefit on the other party." *Id.* at § 370 cmt. a (citing *Restatement of Restitution* § 1 cmt. b (1937)). "The benefit may result from the transfer of property or from services, including forbearance." *Id.*

The *Restatement* precludes restitution when the nonbreaching party cannot return "any interest in property that he has received in exchange in substantially as good condition as when it was received by him . . . ." *Id.* at § 384. If the nonbreaching party has "used, destroyed or substantially altered in character" property received from the breaching party so that return is not feasible, "restitution is generally not available." *Id.* at § 384 cmt. a. Defendant argued that the Citizen's

transaction is not appropriate for restitution because the bank was "substantially altered" while in the possession of the holding company. (Def.'s Post-Trial Br. at 33 n. 3.)

> It was held as a separate subsidiary for one year and then merged in the operations of Old Stone Bank. It was sold in its entirety in May of 1990, four-and-one-half years after OSC had acquired it. During this time period, hundreds, if not thousands, of business decisions were made; assets were sold; assets were purchased; and numerous financing decisions were made.

(*Id.*)

If we are to consider the possibility of restitution as a remedy at all, this rule cannot apply to these circumstances. The requirement that property obtained according to contract must be returned in the same condition for restitution is inappropriate for a transaction of this type, where commingling is "the inherent nature of the . . . transaction . . . ." *Hansen*, 367 F.3d at 1318-19. The Federal Circuit noted in *Hansen* that

> stock is an asset with a monetary value, just like cash. If it is proper . . . to reimburse the Hansens via restitution for their cash contribution, it would seem appropriate to do the same as far as the value of their stock is concerned. In short, we fail to see a compelling distinction between these two assets that would counsel us to allow restitution of the cash, but prohibit restitution of the stock.

Id. at 1317.

B. Reliance

"'Reliance is an ideal recovery in Winstar cases.'" *Glendale* 378 F.3d at 1313 (quoting Jon W. Burd, *Where The Rabbit Hole Ends: A Working Model For Measuring Winstar-Type Damages In The Federal Circuit*, 13 Fed. Cir. B.J. 657, 685 (2004)). Some damages are too attenuated or too speculative

to qualify for award, however. The non-breaching party is entitled only to damages that are foreseeable. *Hadley v. Baxendale*, 9 Exch. 341 (1854), first established the rule that contract damages must be foreseeable to the parties at the time of contracting. Damages must be either "(a) injuries which will flow naturally from the breach in the ordinary course of events, [or] (b) injuries which arise from plaintiff's special needs or circumstances of which [the breaching party] has knowledge or reason to know." *Restatement (Second) of Contracts* § 351 (1981).[19]

Reliance does not require total breach; neither does the windfall defense apply. The burden of establishing that plaintiff would have suffered losses independent of the breach falls on defendant. *See American Capital Corp. v. United States*, 59 Fed. Cl. 563, 575 (2004); *see also Restatement (Second) of Contracts* § 349 (1981) ("the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that *the party in breach can prove with reasonable certainty* the injured party would have suffered had the contract been performed." (emphasis added)).

C. Mitigation

Plaintiff argues mitigation damages as an alternative theory of recovery. Costs incurred in a reasonable but unsuccessful effort to avoid loss are recoverable as incidental losses. *Restatement (Second) of Contracts* § 350 cmt. h (1981). Incidental losses include such costs, irrespective of whether such efforts are successful. *Id.* at § 347 cmt. c. Defendant acknowledges that "costs incurred in mitigating the effects of

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[19] See *Restatement (Second) of Contracts* § 349 (1981) for a discussion of essential reliance, the actual outlay of funds essential to plaintiff's performance under the contract, and incidental reliance, which consists of costs incurred in preparation for collateral transactions that a party plans to carry out when the contract is performed.

a breach may be recoverable as damages," but cautioned that the recovery of such costs is "not without limits." (Def.'s Post-Trial Br. at 50 (citing *Restatement (Second) of Contracts* § 347(b) (1981)).)

The *Restatement* sets out the limits:

> (1) Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.
>
> (2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.

Restatement (Second) of Contracts § 350 (1981).

Plaintiff made every reasonable effort to mitigate its damages after the breach. Not only did it abide by the terms of the Net Worth Maintenance Stipulation, but also it filed Capital Plans and complied with the Capital Directive. At the regulators' direction, plaintiff improved the bank's capital ratios, but in the process stripped itself of most operating subsidiaries that were producing earnings. Mr. Rosati testified about cost-cutting efforts undertaken by management after the breach, which resulted in substantial savings.

Defendant argues that the $74.5 million downstreamed cannot be mitigation damages because Old Stone Corporation transferred the funds as part of its obligation under the Net Worth Maintenance Stipulation.[20] We are mindful of the Federal Circuit's direction in *Glendale*, however: "we remain optimistic that within the additional guidance and support given the trial court . . . the remainder of the Winstar cases can be disposed of . . . based on the particular facts of the

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[20] The Government stated during its argument against restitution that plaintiff performed under the Net Worth Maintenance Stipulation voluntarily.

case, and without further dispute over the theory on which damages may be calculated." 378 F.3d at 1313.

III. PLAINTIFF'S CLAIMS

Plaintiff identified four claims during summary judgment proceedings that it considered to be qualified for "*Landmark*-style" restitution:[21] (1) $103.2 million for stock in Old Stone commercial bank that the holding company Old Stone Corporation contributed to the failing thrift, Rhode Island Federal; (2) $74.5 million that Old Stone Corporation downstreamed to Old Stone Bank, FSB as required by the Net Worth Maintenance Stipulation;[22] (3) $13.8 million cash contribution to Rhode Island Federal as required by the FDIC; and (4) $14.8 million cash contribution made to acquire another thrift, Citizens Federal Savings Bank. We denied plaintiff's motion for summary judgment, and plaintiff presented similar claims at trial using various legal theories of recovery. *Old Stone Corp. v. United States*, No. 92-647C (Fed. Cl. Mar.28, 2003).

A. Stock Contribution

The holding company seeks return of the value of stock that it contributed to Rhode Island Federal in connection with the merger of the banks.[23] Plaintiff claims that the holding company transferred its stock in Old Stone Bank to Rhode Island Federal to recapitalize the thrift as required by the

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[21] *See Landmark Land Co. v. United States,* 46 Fed. Cl. 261, 267 (2000), *aff'd in part, rev'd in part, vacated in part sub nom. Landmark Land Co. v. FDIC,* 256 F.3d 1365 (Fed. Cir. 2001).

[22] Net worth maintenance stipulations often required institutions to maintain a bank's capital at minimum levels where, as in the case of Old Stone Corporation, the institution otherwise would have no such liability.

[23] The parties do not dispute the value of the stock; it was approximately $103 million.

Assistance Agreement.[24] Plaintiff contends that this justifies an award of money-back restitution. Defendant argued at trial that plaintiff did not recapitalize the thrift and that the Assistance Agreement did not require plaintiff's contribution of stock. Defendant insisted that plaintiff's contribution was merely a "condition precedent" to the Agreement and that it was FSLIC that recapitalized Rhode Island Federal with its contribution of $9.55 million. Rhode Island Federal had a net worth deficit of $4.4 million after FSLIC made its contribution. Defendant questioned why FSLIC would demand that plaintiff contribute nearly $103 million in capital to fill a $4.4 million negative net worth.

Dr. Cone testified as an expert for the Government. His opinion was that the $103.2 million stock contribution did not capitalize Rhode Island Federal but supported Old Stone Bank. This capital would have been necessary to support the commercial bank at the 5.5% ratio required by FDIC. (Tr. at 1795.) Defendant argued that Rhode Island Federal's initial $13.9 million contribution of regulatory capital was sufficient to capitalize Rhode Island Federal at the 5.5% level, with $6.7 million left over to support the Old Stone assets. Thus, Dr. Cone believes that Rhode Island Federal essentially contributed capital to Old Stone rather than the other way around.[25] He also stated that plaintiff's restitution claim does not account for the profit Rhode Island Federal generated for

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[24] This is the commercial bank stock that plaintiff transferred to Newco. Newco was a service company that had been organized to receive the stock on behalf of Rhode Island Federal.

[25] Dr. Cone's testimony was oddly vague and imprecise. His memory of the expert report that he offered was limited. During his deposition, Dr. Cone did not know which regulatory agency was responsible for examining federally chartered savings associations. "I don't recall" and "I would have to check" were frequent refrains throughout his deposition. (*See* Tr. at 1891-95.) He seemed only slightly more familiar with this case on the stand.

plaintiff after the acquisition. This included $60 million in dividends.[26]

The Federal Circuit addressed the potential value of a stock exchange recently. See *Hansen*, 367 F.3d 1297. The agreement in *Hansen* required that the Hansens contribute $1 million to Hansen Savings and exchange all of their stock for stock of Hansen Savings. A state law required that the bank exchange its shares for shares in the acquiree thrift, and the assistance agreement so provided. The trial court saw "no basis to find that the exchange of stock was a transaction that caused either a loss to plaintiffs or a benefit to defendant" according to the facts presented there. *Hansen*, 53 Fed. Cl. at 108. The Hansens were not "strictly 'performing' a duty set forth in the Assistance Agreement" by transferring the stock. *See Hansen*, 367 F.3d at 1307 (explaining the reasoning of the trial court). The "mere repetition of the requirement" in the FHLBB resolution that Hansen give up its shares did not "elevate it to a contractual term compensable by restitution." *Id.* The stock exchange did not diminish the Hansens' ownership because they retained a controlling interest in the surviving entity. The court ruled that a "contribution" would have required surrender of the Hansens' controlling interest. *Id.* The Circuit stated on appeal that

> stock is an asset with a monetary value, just like cash. If it is proper . . . to reimburse the Hansens via restitution for their cash contribution, it would seem appropriate to do the same as far as the value of their stock is concerned. In short, we fail to see a compelling distinction between these two assets that would counsel us to allow

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[26] The Circuit has ruled that dividends are not credited to the Government in restitution unless they came from the Government. *Landmark*, 256 F.3d at 1373-74, ("[The] government's actions were simply not relevant to the dividends."). Here, the dividends (and the profits) were generated entirely by the bank. Dr. Cone was an ardent advocate for the Government's legal and factual positions.

> restitution of the cash, but prohibit restitution of the stock.

Hansen, 367 F.3d at 1317. Regarding the state law requirement, the Circuit ruled that the requirement remained a condition of the contract. *Id.* That it also happened to be required under New Jersey law "did not negate the fact that the stock exchange was an explicit term of the Hansen's contract with the Government." *Id.* The Circuit added, "[t]he pivotal question . . . is whether an award of restitution would place the Hansens in an overall better position than if the breach of contract had not occurred." *Id.*

The appeals court found that transfer of stock in the circumstances presented could be a valuable benefit to the Government:

> The availability of restitution insofar as the [stock transfer] is concerned thus turns on whether the stock transfer is properly viewed as having conferred a "benefit" upon the government. *We think that it did.* . . . [T]here is no doubt that the merger was desirable from the FSLIC's point of view. By assuming the liabilities of [the failing thrift], the Hansens allowed the FSLIC to avoid the high cost of bailing out another insolvent thrift. At the same time, the investment of the . . . shares into Hansen Savings was an essential component of the merger. In these respects, the stock exchange "advanced" the government's "interests."

Hansen, 367 F.3d at 1316 (citing *Restatement (Second) of Contracts* § 371 (1981)) (emphasis added).

The Circuit emphasized the fact that the owners gave up incidences of ownership in the stock even if they did not lose its value entirely. *See id.* The *Hansen* court found that such limitations on rights of ownership can be significant in determining whether plaintiff has transferred "benefits" to the Government or incurred costs. 367 F.3d at 1315-17. The

holding in *Hansen* regarding the value of a stock exchange may be distinguished in some respects from the exchange of stock in this case. The trial court's ruling came on a motion for summary judgment.

Plaintiff's contribution of stock with a value of $103 million was a benefit to defendant's insurance system. Plaintiff's downstream of $74.5 million helped support the bank and it benefitted the system as well. The parties did not explain fully how such contributions should be quantified, however. Plaintiff assumes a dollar-for-dollar benefit, while the Government contends that the value is zero. Defendant argued in its post-trial reply brief that "*no* witness testified that FSLIC or the FHLBB saw the transaction as a 'huge benefit.'" (Def.'s Post-Trial Reply Br. at 5.) This does not add much to the court's understanding of a complex topic. To say that the transaction was a not a "huge benefit" does not help us quantify the benefit any more than Dr. Cone's assertion that the value was "far less than $103 million" (Tr. at 1927).

Dr. Cone acknowledged that the $103 million was a "cushion" for FSLIC, that FHLBB saw this cushion as a benefit, that the transaction provided an immediate benefit, and that it saved the Government from spending money to resolve the Rhode Island Federal issue. (Tr. at 1936-41.) He testified that Old Stone Bank paid about $1.5 million per year in premiums to FSLIC. (Tr. at 1943.) He also acknowledged that Old Colony, another bidder at the same level of priority, failed within in a year of the Rhode Island Federal transaction. (Tr. at 2111-12.)

B. Post-Breach Contributions

Plaintiff's witnesses and counsel spoke often of the holding company's surrender of perfect immunity from the obligations of the bank as a result of the Net Worth Maintenance Stipulation. The effect of the Stipulation was to pledge the Corporation's entire net worth to support the troubled bank.

The regulators could have enforced the Net Worth Maintenance Stipulation before the breach as well as after, but until after the breach they had no reason to demand the infusion of capital. Old Stone Bank had been in compliance with its then-existing capital requirements before the elimination of its supervisory goodwill.

Old Stone Corporation downstreamed $75 million to Old Stone Bank pursuant to the Net Worth Maintenance Stipulation after breach. Plaintiff claimed during arguments on its motion for summary judgment that Old Stone is entitled to restitution for this amount because it was paid in response to a contractual obligation.[27] *See Landmark*, 256 F.3d at 1375; *Glendale*, 239 F.3d at 1379-80 ("[W]e have allowed restitution for the limited purpose of returning the acquiring thrift to the status quo ante when *specific initial contributions* to an acquired thrift have been established." (emphasis added)).

Restitution generally is not available post-breach. That is, the non-breaching party normally may not be awarded restitution for costs incurred after the breach. Performance by the non-breaching party post-breach is the act of a volunteer. The breaching party will have given him sufficient notice to suspend performance and to prevent additional losses. This accords with the duty to mitigate.

The Net Worth Maintenance Stipulation states that it was entered into by the parties in consideration of the Assistance Agreement; each was incorporated by reference into the other. Defendant breached the Assistance Agreement. By its own terms, the Net Worth Maintenance Stipulation survives the Assistance Agreement. Presumably, the survival provi-

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[27] Both net worth maintenance stipulations contained language requiring that capital be maintained "except to the extent the Bank Board has agreed to forbear from enforcement of such [FSLIC capital] regulations." (Pl.'s Exs. 135, 209.) The parties did not argue the effect of this language on plaintiff's obligations and we have not considered it.

sion relates to a voluntary termination of the Assistance Agreement rather than a breach, but this raises an issue that we need not decide to resolve this case.

The Government contended during its argument against restitution that plaintiff performed the Net Worth Maintenance Stipulation voluntarily. The holding company had no obligation to maintain the bank's net worth absent the Net Worth Maintenance Stipulation. How-ever, the Government conditioned its acceptance of plaintiff's Capital Plan on Old Stone Corporation's compliance with the Net Worth Maintenance Stipulation. Plaintiff had to fulfill its obligation under the Stipulation before the Government would sign off on the Capital Plan that plaintiff submitted for approval. (Tr. at 329-30.) The bank depended on approval of the Capital Plan to remain in business. (*Id.*)

In theory at least, Old Stone Corporation could have ceased performance of the Net Worth Maintenance Stipulation once the Government breached the Assistance Agreement by enacting FIRREA. Upon material breach of a contract, the nonbreaching party has the right to discontinue performance of the contract and to seek redress in accordance with law. *Malone v. United States*, 849 F.2d 1441, 1445-46 (Fed. Cir. 1988), *modified by* 857 F.2d 787 (Fed. Cir. 1988); *Cities Serv. Helex, Inc. v. United States*, 211 Ct.Cl. 222, 234-35, 543 F.2d 1306, 1313 (1976). The holding company could have done this by not downstreaming capital to the subsidiary bank as required by the Net Worth Maintenance Stipulation. In practice, this is a problem that is exemplary of those described by the Federal Circuit in *Glendale.*

The Circuit commented that the "problem with which the trial court has had to wrestle has been finding a viable damages theory that fits the complex fact patterns of these cases, one that is fair to the damaged thrifts, but is based on real losses sustained so as not to overcompensate for the

breach." *Glendale*, 378 F.3d at 1308. The appeals court directed that the we consider reliance damages in ruling on most *Winstar* cases. *Id.* "'Reliance is an ideal recovery in Winstar cases.'" *Glendale*, 378 F.3d at 1313 (quoting Jon W. Burd, *Where The Rabbit Hole Ends: A Working Model For Measuring Winstar-Type Damages In The Federal Circuit*, 13 Fed. Cir. B.J. 657, 685 (2004)). "'Despite the landscape where alternative forms of recovery are speculative and loss models inherently unreliable, reliance damages can be ascertainable and fixed.'" *Id.*

The principle of reliance is that a party who relies on another party's promise made binding through a contract is entitled to damages for any losses actually sustained as a result of the breach of that promise. *See Glendale*, 239 F.3d at 1382-83. The important aspect of reliance damages for the purposes of this case is that reliance damages are available for costs incurred both before and after the breach. The standard for reliance damages is not whether the expenditures were required under the contract, but whether the expenditures were made in reliance upon the contract. Plaintiff need show only that it spent money because of the contract. *Landmark* 256 F.3d at 1379; *Restatement (Second) of Contracts* § 344(b) (1981).

Defendant argued that Old Stone's losses "stemmed directly from its own decision to become heavily involved in international loans, investments in commercial real estate, and commercial real estate lending." (Def.'s Post-Trial Br. at 51.) This suffers from the same speculation and lack of proof described earlier. Defendant cannot blame Old Stone's demise on "a downturn in the economy" (*id.* at 52) when the regulatory capital for which the bank contracted was intended partly to shield the plaintiff from such losses. The bank had acquired $95 million of regulatory capital through its mergers with Rhode Island Federal and Citizens. This was thirty-five percent of its total capital. (Tr. at 1213-14.)

Defendant states th because OSC had entered into a binding net worth maintenance [stipulation], it was obligated to make the infusions of capital . . . without the breach" (Def.'s Post-Trial Br. at 36), apparently meaning that the contributions were not required by the Assistance Agreement. Plaintiff would not have had reason for the infusions absent the elimination of the bank's regulatory capital by FIRREA.

Plaintiff had two options after FIRREA's passage, according to defendant:

> It could either have terminated the agreement and claimed entitlement to restitution . . . or it could have continued to perform under the agreement and sought damages for partial breach. Plaintiff chose the latter option. Having made that choice to continue under the agreement, plaintiff may not now claim restitution. The facts of this case demonstrate why allowing it to do so *would be so unjust.*

(Def.'s Post-Trial Br. at 39 (emphasis added).) The irony of this argument, however, is that plaintiff's continued performance, the "latter option," was its compliance with the Net Worth Maintenance Stipulation—apparently under some duress.[28] It is difficult to understand defendant's argument that a contribution of $74.5 million to an entity guaranteed by the United States "would be so unjust."

C. Citizens Federal Contribution

Old Stone Corporation purchased Citizens Federal, a troubled thrift institution in Seattle, Washington as of December

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[28] Several witnesses for plaintiff testified about their concerns that regulators would assess penalties and take other enforcement actions including the issuance of cease and desist orders to enforce the capital plan and indirectly the Net Worth Maintenance Stipulation. (*E.g.*, Tr. at 1014-15.) The total capital downstreamed by the corporation to the bank was $74.5 million, an amount not in dispute. The amounts were $45.463 million in 1990; $27.5 million in 1991; and $1.5 million in 1992. (Tr. at 315.)

27, 1985. Citizens had a net worth deficit of over $30 million and substantial unrealized losses. The cost of liquidating the bank was estimated at $92 million. The Assistance Agreement among FSLIC, Old Stone Corporation, and Citizens Federal (Pl.'s Ex. 209) required FSLIC to make a cash contribution of approximately $79 million for the acquisition and called for various other forms of assistance and forbearances. The FHLBB approved the proposal in part because it was the best offer and it cost less than liquidation.

The Agreement provided that Old Stone Corporation would contribute cash equal to three percent of its total assets, or $14.8 million at the time. Old Stone changed the name of Citizens Federal to Old Stone Bank of Washington and sold it several years later for a $9.5 million pre-tax profit. This claim represents a pure example of money-back restitution, where the contract required plaintiff to contribute three percent of its capital or $14.8 million to purchase a failing thrift, Citizens Federal. *See Landmark*, 256 F.3d at 1375 (For restitution, "plaintiff's contribution must have been made in performance of its contractual obligations."). The parties did not argue the legal effect of the profit to any extent during trial. Defendant's brief asserts that evidence "established that during its ownership of [Old Stone Bank of Washington], [Old Stone Corporation] obtained a 40 percent return on its investment." (Def.'s Post-Trial Br. at 57.) If defendant derived this number merely by dividing $14.8 million by $9 million, Dr. Cone testified that none of the profits found their way to the holding company, which is the plaintiff in this action.[29] (Tr. at 1980-81.) Defendant's other comment on the issue is that "OSC has presented no evidence showing it

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[29] Dr. Cone testified that none of the money paid to the bank for the sale of Old Stone Bank of Washington was "dividended" to plaintiff holding company. (Tr. at 1980-81.) Thus, plaintiff did not have the benefit of the profit or the earnings. Presumably what was left of the benefits from that sale went to the Government when it seized the bank in 1993.

was in any way harmed by the sale" of Citizens Federal. (Def.'s Post-Trial Br. at 57.)

Plaintiff sold Old Stone Bank of Washington because it had to raise capital. This came during the period of "shrinkage" that is discussed elsewhere in this Opinion. Banks make money through returns on assets, or earnings. Mr. Rosati explained that bank operations are different from those of other businesses or of household accounts, where paying down liabilities results in increased cash flow because less money does to paying principal and interest.

Mr. Rosati explained further:

> [B]anks will take deposits or borrow money, which are called liabilities, and then take those liabilities and then lend them out and make loan[s] . . . . And the bank makes money by the spread between the cost of the liabilities and the [income from] the loan. Now, the problem you have is that if you continue to shrink by selling your assets to pay off your liabilities . . . you cross over because the bank has fixed operating expenses. . . . [Y]ou can finally shrink yourself out of existence, because you will have no liabilities but you [also] will have no assets. . . . [A]ll you'll have is fixed overhead and you'll fail.

(Tr. at 2386-87.) Mr. Rosati testified that the bank had approximately $3.4 billion in total assets at its peak. (Tr. at 2388.) The total after shrinking was about $1.8 billion. (*Id.*) He testified that this had a material effect on the bank's operations. (*Id.*) He said, "once you sell your subsidiaries and you shrink the size of the balance sheet you put yourself in a position where you cannot leverage your liabilities into assets, where you cannot generate a profit." (*Id.*) This is not a lost profits case, so the effect of shrinkage is not a major issue in determining damages, but it addresses the notion that plaintiff was not harmed by shrinkage.

The Circuit has approved restitution damages in limited fact situations, particularly where the contribution is a clear, contractual requirement. *See, e.g., Glendale*, 239 F.3d at 1381 ("[W]e have allowed restitution for the limited purpose of returning the acquiring thrift to the status quo ante when *specific initial contributions* to an acquired thrift have been established." (citing *Landmark*, 256 F.3d at 1365) (emphasis added)). Defendant argued that the Assistance Agreement in this case did not require plaintiff to make the stock contribution. Such a requirement would be necessary not only for restitution but also to compensate plaintiff according to a reliance theory for purposes of the foreseeability analysis. *See, e.g., Landmark*, 256 F.3d at 1375, 1378-79. Implicit in the Government's argument is the notion that the Agreement's terms were not negotiated in the sense that government officials had a real stake in the outcome. Defendant suggests that all the regulators wanted was to buy time, and that the entire process was plaintiff's way of reorganizing its corporate structure. See *Hansen*, 367 F.3d 1297 (Fed. Cir. 2004), and our discussion below.

Defendant pointed out that the provision requiring plaintiff to transfer its stock in the bank to Rhode Island Federal is a part of the *Recitals* of that Assistance Agreement (Pl.'s Ex. 135), while required capital contributions are in the *Agreement* portion. The *Summary of Substantive Provisions* at the beginning of the contract lists FSLIC's cash contribution of $9.5 million to Rhode Island Federal but not a $103.2 million contribution of stock by plaintiff. Defendant believes this establishes that only the $9.5 million that FSLIC contributed to the thrift was meant to recapitalize the thrift.

The requirement that plaintiff transfer stock of its commercial bank subsidiary may be found both in the *Recitals* and in the *Conditions* section of the *Agreement* portion. The *Recitals* include the following:

D. On the Effective Date, *HOLDING COMPANY will make a capital contribution of all of the stock of [the commercial bank,] to a newly formed, wholly owned, first tier service corporation of [Old Stone Bank,] FSB[, Newco].*

E. On the Effective Date, [the commercial bank] will transfer substantially all of its assets, except assets relating to certain trust operations of [the commercial bank], to [Old Stone Bank,] FSB, and [Old Stone Bank,] FSB will assume substantially all of the liabilities of [the commercial bank].

F. *In consideration of the mutual promises contained in this Agreement, the parties enter into the following agreement.*

(Pl.'s Ex. 135 at 2 (emphasis added).) The *Agreement* portion appears next with § 1, "*Definitions*," and § 2, "*Conditions.*" Subsection (a) under *Conditions* states:

> The obligations of the parties under this Agreement are subject to the occurrence of the following: . . . [*inter alia*] *[t]he transfer of all of the issued and outstanding stock of [the commercial bank] by HOLDING COMPANY to Newco, a Rhode Island corporation, which shall be a wholly owned, first tier, subsidiary of [Old Stone Bank,] FSB.*

(Pl.'s Ex. 135 at 4 (emphasis added).) The language in the *Agreement* portion characterizes the contribution as a "condition." The *Conditions* section states that "[FSLIC]'s obligations . . . are . . . conditioned upon the execution and delivery of a Dividend Limitation Stipulation and a Net Worth Maintenance Stipulation . . . ."[30] (Pl.'s Ex. 135 at 7-8.)

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[30] A partial list of actions required by the contract that also are included under the *Conditions* section of the *Agreement* portion follows:

• Purchase of all Old Stone Bank, FSB stock by the Holding Company

The Assistance Agreement for the Citizens Federal acquisition (Pl.'s Ex. 209) provides an important contrast to the Agreement for Rhode Island Federal (Pl.'s Ex. 135), according to defendant. The *Recitals* sections in each end with an identical Paragraph F: "[i]n consideration of the mutual promises contained in this [Assistance] Agreement, the parties enter into the following agreement." As in the Rhode Island Federal Assistance Agreement, the *Agreement* portion of the Citizens Federal Assistance Agreement begins with § 1, "*Definitions*," and § 2, "*Conditions.*" Section 3, "*Contributions by [Old Stone Corporation]*," however, is listed under *Conditions.* Section 3 provides that "OSC shall contribute cash to FSB in an amount equal to 3% of FSB's total assets . . . ." (Pl.'s Ex. 209 at 8.) The section explains how the contribution will be calculated and where the money will be wired. The following section, "*Contributions by [FSLIC]*," sets out the amount and timing of FSLIC's cash contributions, its indemnification contributions, and contributions resulting from assignment of acquired claims.[31] (Pl.'s Ex. 209 at 9-11.)

- Transfer of all of the commercial bank's stock to Newco
- Transfer of all assets of the commercial bank to Old Stone Bank, FSB
- Plaintiff's agreement to restrict Old Stone Bank, FSB's operations
- Delivery of legal opinions from counsel for Old Stone Bank, FSB
- Delivery of legal opinions from counsel for the Holding Company
- Delivery of legal opinions from counsel for the commercial bank
- Delivery of legal opinions from counsel for Newco
- Delivery of Corporate Resolutions approving all transactions
- Delivery of a Dividend Limitation Stipulation
- Delivery of a Net Worth Maintenance Stipulation

(Pl.'s Ex. 135.)

[31] FSLIC also gave Old Stone Bank of Washington an option to sell a troubled loan from Citizen Federal to Bay Vista Condominiums for $14 million cash. The option was good for 60 days.

The two Assistance Agreements entered into by essentially the same parties at about the same time, are markedly different in the important respect of plaintiff's obligations to make capital contributions, according to defendant. No mention is made of the $103 million stock transfer in the *Contributions* section of the Rhode Island Federal Assistance Agreement. This section contains only FSLIC's cash contribution. The Citizens Federal Assistance Agreement, in contrast, lists both parties' contributions.

Plaintiff characterizes such arguments as semantics and points out that the court may not use captions to construe the contract. (*See* Pl.'s Exs. 135 § 16(c) at 26, 209 § 19(c) at 34-35 ("Section headings are not to be considered part of this Agreement . . . and shall not affect the meaning or interpretation of this Agreement or any of its provisions.").) It is not clear whether the contract rule against considering section headings applies to defendant's arguments on this point, but we do not think it necessary to decide that issue.

The initial contribution of stock and assets was required of plaintiff to give the contract effect. The same is true of plaintiff's obligation to deliver the Dividend Limitation Stipulation and the Net Worth Maintenance Stipulation. These provisions were consideration to the Government, and they were central to the agreement. No other sections of the Assistance Agreement require Old Stone Corporation to perform; all obligations are in the *Recitals* or the *Conditions*. Whether the requirements were terms or conditions, the parties responded initially and abided by the provisions until the breach. "[W]hen parties enter into a contract, each and every term and condition is in consideration of all the others, unless otherwise stated." *Stone Forest*, 973 F.2d at 1552. "Unless justice so requires, courts should hesitate to rewrite a contractual arrangement after a material breach by one party . . . ." *Id.*

A resolution of the Federal Home Loan Bank Board approving Old Stone's acquisition of Rhode Island Federal (Pl.'s Ex. 107.) is a part of the contract in this case. The Resolution's purpose was to approve the supervisory conversion of Rhode Island Federal to a Federal Stock Savings Bank and plaintiff Old Stone Corporation's acquisition of the resulting stock.[32] The FHLBB Resolution includes the following provision:

> [T]he conversion of [Rhode Island Federal] from a federally-chartered mutual savings and loan association into a federally-chartered stock savings bank, to be called Old Stone Bank, a Federal Savings Bank, is hereby approved, *provided* that: . . . *Old Stone Corporation has contributed its stock in [the commercial bank] to Newco* . . . .

(Pl.'s Ex. 107 at 3-7 (second emphasis added).)

D. The FDIC Assessment

Old Stone was a commercial bank before the merger and thus insured by the Federal Deposit Insurance Corporation. The FDIC's policy at the time was to require banks leaving the Fund to meet capital ratios required of commercial banks. *See* 12 U.S.C. § 1828(c) (authorizing the FDIC to approve transfer of commercial bank assets out of the Fund). Old Stone initially claimed restitution for the $13.8 million cost of increasing the bank's capital ratio to 5.5 percent before it was permitted to leave the FDIC's fund. Plaintiff essentially abandoned the claim, however, near the end of trial.

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[32] The Federal Home Loan Bank Board was authorized to convert a mutual institution into a stock institution or a federal stock savings bank in certain circumstances. For example, it could permit such a conversion "if the Board has determined that severe financial conditions exist which threaten the stability of an institution and that such authorization is likely to improve the financial condition of the institution . . . ." 12 U.S.C. § 1464(p)(2). That occurred in this case. Rhode Island Federal, a federal mutual savings and loan association, became a federal stock savings bank.

The Assistance Agreement between Old Stone and FSLIC includes a requirement that plaintiff obtain "[s]uch approvals by the Federal Deposit Insurance Corporation of the foregoing transactions as are legally necessary."[33] (Pl.'s Ex. 135 at 5.) The FDIC imposed the obligation to improve the bank's capital ratio to a minimum 5.5 percent as consideration for Old Stone Bank's leaving the FDIC's insurance fund. This accorded with FDIC policy at the time apparently. Plaintiff agreed to that requirement at least a month before signing the contract with FSLIC, presumably because the FDIC could have prevented plaintiff's reorganization as a federal savings bank. *See* 12 U.S.C. § 1828(c). The contribution was made in connection with the overall transaction, which would not have been approved absent plaintiff's acquiescence. Plaintiff offered no evidence concerning the claim during trial, however, and advised the court later that it would abandoned the claim.

IV. DEFENDANT'S ARGUMENTS

Defendant argued that if the Government had not seized the bank, "there is no basis to conclude that it would have survived or been profitable in the future." (Def.'s Post-Trial

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[33] Plaintiff questioned whether FDIC had the authority to demand a contribution to capital before leaving the Fund. However, Old Stone Bank's September 1984 application to the FDIC to transfer its assets to Rhode Island Federal, contains the following representation:

> This transaction has been structured so that the resultant institution would be a federal savings bank insured by the Federal Savings and Loan Insurance Corporation. While the resultant federal savings bank would have a pro forma tangible adjusted capital ratio somewhat below the level the Corporation considers acceptable for an institution of this size, *Old Stone Bank has committed to raise sufficient additional equity capital by December 31, 1985 so that the resultant institution will have a tangible adjusted equity capital to assets ratio of at least 5.5 percent.*

(Def.'s Ex. 18 at 4 (emphasis added).)

Br. at 35.) There was no evidence that any of the attempts of Mr. Rosati to save the bank would have been successful in the non-breach world or that anyone would have come to the bank's assistance. (*Id.*) However, defendant's doubts are speculative.[34] Defendant did not establish that the bank would have failed regardless. If it had made such a showing, defendant also should have shown what the effect on the holding company would have been. Old Stone Corporation is the plaintiff here.

The Government did not prove the losses that plaintiff would have suffered absent the breach. It would have been difficult for defendant to make such a showing in the "but for world," as demonstrated in plaintiffs' lost profits cases here. See, for example, *Westfed Holdings, Inc. v. United States*, 55 Fed. Cl. 544, 558-60 (2003) (granting reliance damages to holding company plaintiff and refusing to offset such reliance damages because the Government failed to prove with reasonable certainty that the holding company would have suffered losses absent the breach), where government experts did not develop a model to support their views of what losses the thrift would have incurred in the but for world of no breach.

We think it highly unlikely that the regulators would have seized the bank in 1993, absent the breach. A memorandum from Mr. Peckham to Mr. Vigna dated December 4, 1992 stated,

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[34] For example, government counsel argued as follows during trial:

> [T]he *inference* is, in the nonbreach world, they would be in the exact same place; and the [Office of Thrift Supervision] would have taken the exact same steps. . . . [Old Stone Corporation] would have had to downstream capital to try to keep the bank alive. [It] *would have probably* had to sell off [its] subsidiaries to solve the commercial paper problem because [it] would have been in the exact same, if not worse, position.

(Tr. at 2857 (emphasis added).)

> [f]or the first 9 months of 1992, and before provisions for credit/REO losses, OSB earned $9.5 million compared to a loss of $18.1 million for the same period in 1991. Of the $28 million in improvement, $6 million is due to spread improvement, $7.2 million to improved non-interest income and $14 million to reduced non-interest expense. This trend demonstrates that core earnings power is being restored. . . .

(Pl.Ex. 504 at 6.) The bank was profitable on an operating basis in December 1992 and January 1993. (Tr. at 1988.) Plaintiff presented evidence that the bank would have had more than $65 million in regulatory capital on the books at seizure had the Government not breached its contract.

Dr. Cone testified that a damage award of "over $200 million" would result in a windfall because it would make Old Stone Corporation better off than without the breach. (Tr. at 1773.) This is because the losses "were not caused by the breach," but "were caused by [the bank's] own strategy." (Tr. at 1882-83.) This testimony was not credible. Dr. Cone was critical of the bank's portfolio and its policies in general. These problems resulted in part because of general economic conditions at the time. Such problems would have been eased by the bank's having had a capital cushion. Old Stone acknowledges that factors other than the breach affected the bank's operations during the period after the breach. Plaintiff argues, however, that it would have survived with the benefit of the capital cushion provided by the regulatory capital for which it contracted. We believe this is so. Credible evidence and testimony offered during trial support this finding.

Expert witnesses in some *Winstar* cases have argued in effect that the Government did the banks a favor by breaching their contracts. Here, government counsel states that the bank would have been "in a more precarious capital position absent the breach" because it would have had the same bad assets and losses that were unrelated to the breach. (Def.'s Post-

Trial Br. at 33.) The meaning of this argument is not clear, but defendant did not prove it in any event.

Defendant argues essentially that plaintiff did not need the regulatory capital and the various types of assistance in the Assistance Agreement and did not negotiate for them. Defendant suspects that all plaintiff wanted was a thrift charter. *See Landmark*, 256 F.3d at 1374-75 (barring compensation for "strategic business decisions not fairly attributable to the agreement with the government."). Plaintiff acknowledged that it wanted a thrift charter. Its witnesses testified at length about the importance of moving beyond the state of Rhode Island. (*E.g.*, Tr. at 258, 734.) Such testimony does not detract from the fact that the capital provisions and the forbearances were "clear and explicit condition[s] of the contract between the parties." *Hansen*, 367 F.3d at 1317. The Government argued in *Hansen* that it was not responsible for returning the value of plaintiff's stock as restitution because the Hansens had a legal duty under state law to transfer or reissue the stock anyway. *Id.* The Circuit stated that

> [t]he exchange of stock constituted the performance of a clear and explicit condition of the contract between the parties. The fact that it also happened to be required under New Jersey law does not negate the fact that the stock exchange was an explicit term of the Hansens' contract with the government.

Id.

Dr. Cone stated that "all of the divestitures [by Old Stone Bank] would have been required by the end of 1992, even without the breach . . . ." (Tr. at 1874.) This takes into account the 1992 write-off for losses. The Government argued that this meant that "because OSC had entered into a binding net worth maintenance [stipulation], it was obligated to make the infusions of capital [it] made even without the breach." (Def.'s Post-Trial Br. at 36.) This testimony begs

the question. Had there been no breach, plaintiff would not have been required to make contributions pursuant to the "binding net worth maintenance [stipulation]." Dr. Cone did not offer credible evidence for such sweeping testimony. Similarly, government counsel argued, if OSB had not been seized, "there is no basis to conclude that it would have survived or been profitable in the future." (*Id.* at 35.) This is not the standard, however. Defendant has the burden of proof on this point. *See Restatement (Second) of Contracts* § 349 (1981). It did not show that the losses would have occurred anyway.

Defendant highlighted Mr. Rosati's testimony that "[t]he breach had nothing to do with the fact that the real estate markets went soft, [it] had nothing to do with the fact that there were losses inherent in Old Stone." (Tr. at 2495.) His next comment is important as well: "[w]hat the breach did was [take] away our ability to weather the storm, to solve the problems" (Tr. at 2495-96). Regulators who testified were complimentary of plaintiff's management and its efforts to use creative means to save the bank. (*See, e.g.*, Tr. at 1343, 1361.) The bank would have been in full capital compliance but for the breach; that is, adding the regulatory capital back to its balance sheet after breach. The corporation's contributions pursuant to the Net Worth Maintenance Stipulation would not have been necessary.

Defendant's argument that Old Stone's losses "stemmed directly from its own decision to become heavily involved in international loans, investments in commercial real estate, and commercial real estate lending" (Def.'s Post-Trial Br. at 51) suffers from the same speculation and lack of proof described earlier. The Government cannot blame Old Stone Bank's demise on "a downturn in the economy" (*id.* at 52) when the regulatory capital for which it contracted was intended in part to shield plaintiff from such losses.

A. Foreseeability

Plaintiff's loss must have been foreseeable to defendant at the time of contract formation for plaintiff to recover reliance damages. Defendant argues that the Government must have foreseen both the magnitude and the type of damages and that it had no reason to foresee that plaintiff would lose its entire business as a result of the breach. Plaintiff relies on *American Capital*, which holds that

> the Government is not required to know, or even suspect, that a loss would be caused by . . . FIRREA, only that the Government foresaw, at the time the Assistance Agreement was made, the amounts that were being placed at risk and could be lost, regardless of the actual cause of the loss.

59 Fed. Cl. at 576.

Old Stone Bank was $75 million short of its capital requirements after the breach. This was a wholly foreseeable consequence of the enactment of FIRREA. It was also foreseeable that regulators subsequently would demand that Old Stone Corporation prop up its failing subsidiary with infusions of capital once Old Stone Bank fell short of its capital requirements. The regulators had every reason to pursue Old Stone Corporation given the leverage with which the Net Worth Maintenance Stipulation provided them. This was a function of their regulatory authority.

The Government argued, "[e]ven if OSB had not been seized, assuming there had been no breach, there is no reason to conclude that the losses for which OSC is seeking damages would not have occurred anyway." (Def.'s Post Trial Br. at 48.) Defendant must show more than the bank *might* have incurred the same losses. We concluded that the bank would have survived despite the breach, given more time.

B. Causation

Reliance damages not only must have been foreseeable but also plaintiff must show that they were caused by the breach. *Restatement (Second) of Contracts* §§ 351-52 (1981). Old Stone Corporation downstreamed $74.5 million because of the Government's breach. This expense was the result of plaintiff's obligation under the Net Worth Maintenance Stipulation, so it was certainly foreseeable. Old Stone Corporation had no reason to sell its profitable holdings and sink the resulting capital into the by then troubled Old Stone Bank except for the capital shortfall caused by defendant's breach. Likewise, regulators would have had no reason to implement the Capital Directive absent FIRREA because Old Stone Bank would have been in capital compliance. The $74.5 million downstream was a direct result of the breach.

C. Calculation

Damages must be reasonably capable of calculation. *Restatement (Second) of Contracts* §§ 351-52 (1981). The amounts that Old Stone Corporation downstreamed after the Government's breach are capable of calculation. They were not disputed at trial. None of the other amounts claimed was disputed at trial. We dismiss the FDIC assessment by this Order and Opinion.

D. Benefit to the Government

Defendant challenges the notion that plaintiff conferred a benefit upon the Government because at all times before and after the merger FSLIC guaranteed the deposits in the federal savings bank. The Federal Circuit made his point in the first *Glendale* case: "It is important to remember that, even after [the] merger . . . , the Government was not free of potential liability for the failing thrift. Had interest rates not come down . . . [and had the thrift] failed, the Government's contingent liability would have matured . . . ." *Glendale*, 239 F.3d at 1382. However, the trial court had ruled that resti-

tution damages could be based on the value of goodwill lost by the impact of FIRREA. *See id.* at 1381. The Federal Circuit held that damages could not be measured in terms of "a liability that never came to pass, and based on a speculative assessment of what might have been . . . ." *Id.* at 1382. This is not authority for defendant's argument that the Government obtained no value from the contract.

Dr. Cone attempted to assert that plaintiff's participation in the Assistance Agreement was neither a cost to plaintiff nor a benefit to the Government. He acknowledged on cross-examination, however, that plaintiff's stock contribution was a benefit to the Government "to the extent that Old Stone [Corporation] had other assets that could be used to support the bank . . . ." (Tr. at 1927.) He did not attempt to quantify the benefit to the Government, which of course is a key issue in this case.[35] (Tr. at 1926-29.)

Defendant states that plaintiff's primary motivation in entering the contract was to obtain a thrift charter. Defendant's argument is that the Government did not benefit because plaintiff essentially gave the money to itself in a corporate reorganization. Expenditures made for business reasons unrelated to any duty of performance under the Assistance Agreement are not recoverable as reliance damages. *Landmark*, 256 F.3d at 1375; *Tangfeldt Wood Prods., Inc. v. United States*, 733 F.2d 1574, 1577 (Fed. Cir. 1984) ("In the terminology of the Restatement of Restitution, that benefit was 'officiously conferred' on the Government, and restitution is not owing." (citing *Restatement (Second) of Restitution*, § 2 and illus. 2 (Tentative Draft No. 1, 1983))).

Plaintiff exchanged the commercial bank's stock for that of the new bank. The Court of Appeals for the Federal Circuit addressed this issue in *Hansen*. *See* 367 F.3d at 1316. The Hansens filed a restitution claim for the value of stock they

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[35] *See* excerpts from Transcript *infra* pp. 55-57.

exchanged for stock in the resulting savings bank pursuant to the assistance agreement. While the transfer "did not require a surrender of ownership, it did require a surrender of control," the court ruled. *Id.* at 1317 n. 14. Plaintiffs contributed their stock to a risky venture based on the Government's guarantees under the agreement. The court underscored the Government's promise regarding supervisory goodwill, finding it central to the success of the subsequent savings bank. *Id.* "[T]he merger should be viewed as a *contribution* of stock to a joint and risky venture, rather than as an *exchange* of shares between two entities [both] owned by the Hansens." *Id.*

The Government's post-trial briefs include a number of conclusory arguments concerning the nature of plaintiff's losses and their causes. Defendant notes at one point, "it is uncontested that these losses were unrelated to the enactment of FIRREA or the inability of Old Stone to count the goodwill created as the result of the RIF in Citizens' transactions as regulatory capital." (Def.'s Post-Trial Br. at 55.) This is not at all uncontested. While it is true, as defendant points out, that "goodwill could not absorb real economic losses" (*id.*), goodwill used as regulatory capital could have prevented the Net Worth Maintenance Stipulation from coming into play.[36]

Defendant states that the $74.5 million in post-breach contributions were not made to mitigate the breach but they were "required because OSB's capital rapidly was being depleted due to the serious deterioration of its asset quality and other non-breach related losses." (*Id.* at 51.) In fact, they were required because defendant enforced the Net Worth Maintenance Stipulation. Defendant cannot show that plaintiff's

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[36] Defendant's post-trial briefs rely heavily on Dr. Cone's testimony and conclusory remarks in general. Some of Dr. Cone's key testimony was not credible for reasons stated in this Opinion.

mitigation efforts were unreasonable when it required those very efforts through the Net Worth Maintenance Stipulation. The regulators demanded that the corporation mitigate the effects of the breach on the bank by downstreaming funds totaling $74.5 million. One of the government regulators agreed with plaintiff's counsel that "very, very large civil penalties" were available to the Government for those who did not cooperate, though he noted that "there were all sorts of conditions." (Tr. at 1018.) "It wasn't something that was . . . easily done nor should it have been easily done." (*Id.*)

Defendant questioned in post-trial briefs why plaintiff agreed to the Rhode Island Federal transaction given the concerns that Mr. Rosati and others expressed at trial.[37] For example, counsel cited Mr. Rosati's testimony that the Rhode Island Federal transaction "did not involve a large amount of capital and, standing alone, OSC never would have signed the net worth maintenance stipulation for RIF." (Def.'s Post-Trial Reply Br. at 3 (citing Tr. at 2487-89).) The same question occurs to one reading defendant's own briefs. Defendant stated that

> [Dr. Cone] made clear that the insurance premiums were only half of the equation, and one could not ignore that FSLIC also assumed insurance liability for the $2 billion *risky institution* that OSC merged into RIF, and for which it previously had no insurance liability. . . . [T]here was *no benefit to the Government from this business reorganization* which resulted in an under capitalized commercial bank with *$2 billion of risky assets*, for which the Government, through the FDIC, carried deposit insurance liability, becoming a thrift in-

[37] Defendant also questions why FSLIC would demand that plaintiff contribute nearly $103 million in capital to fill a $4.4 million negative net worth. One answer is that Rhode Island Federal had a net worth deficit of $4.4 million before the transaction. After the transaction the bank was in capital compliance.

> stitution with those same $2 billion in risky assets, and for which the Government, through the FSLIC, continued to maintain deposit insurance liability.

(*Id.* at 5 (emphasis added).) The important point is that the parties negotiated this contract and presumably they had every intention of complying with its provisions when they signed it. Moreover, the parties thought that this plan would work and that it would benefit both sides.

Government regulators stated that Rhode Island Federal was insolvent before the Assistance Agreement was signed, and that its acquisition by Old Stone would "lessen the risk" to the insurance fund. (Pl.'s Ex. 107 at 10.) FHLBB certified that plaintiff's proposal for acquiring Rhode Island Federal, a failing institution, "present[ed] the lowest expense and least risk to the FSLIC of any proposal submitted by a depository institution." (*Id.* at 11.) These statements were made pursuant to statutes authorizing such transactions, so we must assume that they were true when made.

FSLIC insured a bank with a negative net worth of over $4 million before the merger and after the Government's $9 million contribution. After the merger, the same bank had a positive net worth, including stock with a market value of over $100 million. It had liabilities to accompany those assets, but defendant did not offer a means of accounting for that circumstance during trial. Defendant presumptively benefitted because its insurance fund had access to more capital the day after the transaction was performed than it did the day before. It also gained access to the holding company's assets through the Net Worth Maintenance Stipulation. Dr. Cone made no effort to calculate the benefits of plaintiff's contributions under the Net Worth Maintenance Stipulation to the Government or the Stipulation's cost to plaintiff. (Tr. at 1926-28.) He testified eventually that the Stipulation was a cost to plaintiff and a benefit to the Government, but he did not know how much cost or how much benefit. (Tr. at 1922-

26.) This was not useful expert testimony. Dr. Cone's expert testimony did not always meet the required standards of "reliability and helpfulness." *See, e.g., Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 589 (1993); *Fed.R.Evid.* 702.

Dr. Cone acknowledged on cross-examination that plaintiff's contribution of stock to Rhode Island Federal was a benefit to the Government, but he had not calculated that benefit either. He testified only that "[t]here is no way that the costs could have remotely been anything like $103 million." (Tr. at 1927.) He had no idea what the costs would be if not $103 million. These and similar comments that he made during trial did not bolster the court's confidence in his credibility. This is an excerpt of Dr. Cone's testimony on this issue:

Q. . . . [P]rior to the execution of the net worth maintenance [stipulation], Old Stone Corporation was not contractually liable for capital calls made against Old Stone Bank, correct?

A. Yes, that's right.

Q. *Is there a cost to a corporation such as Old Stone Corporation of surrendering its immunity from capital calls and pledging its entire net worth to support its subsidiary?*

A. *Yes.* There would be a cost . . . in general, yes.

Q. So that would be a cost to Old Stone Corporation, correct?

A. *Yes, I think entering into the net worth maintenance [stipulation] would represent a cost, yes.*

Q. And in delivering your opinions in this case, have you attempted, Dr. Cone, to quantify those costs?

A. No.

Q. *Have you attempted to develop an equation or a formula or a calculus to allow you to quantify the extent of the costs to which Old Stone Corporation was*

subjected when it acquired the supervisory thrifts at issue in this litigation?

A. *No.* I think I could make a general statement that *it would be far less than 103 million*, but other than that I haven't tried to quantify it.

Q. But you are kind of *shooting from the hip* with that general statement because you really haven't come up with a formula or calculus, you can't quantify it in any definite sense sitting here today, correct, sir?

A. Well, that's correct, but I'm not shooting from the hip in that observation. There is no way that the costs could have remotely been anything like 103 million.

Q. But you don't know what the cost was, correct?

A. No, I haven't tried to quantify the costs that's correct.

Q. . . . And at the time that Old Stone Corporation incurred this unquantifiable cost, *did that cost deliver a benefit to the Government?*

A. *Yes.* That element of the transaction would have been a benefit to the Government, to the extent that Old Stone [Corporation] had other assets that could be used to support the bank, yes.

Q. *And you haven't attempted to quantify that benefit to the Government either as you sit here today, correct, Dr. Cone?*

A. That's correct. Aside from the observation that it is *not remotely $103 million.*

Q. . . . [S]o when you value a transaction, do you value every element of the transaction separately?

A. I guess it would depend on the facts and circumstances.

Q. *Well, in this case when you delivered your opinion to the Court that . . . there was not a benefit to the Government or a cost to the OSC, were you analyzing*

and evaluating every element of the RIF transaction separately.

A. Well, no. And my opinion is what's stated here.

Q. But your opinion is not then that the RIF transaction did not represent a benefit to the Government or that the RIF transaction did not represent a cost to Old Stone Corporation, correct, Doctor?

. . .

A. I guess my overall opinion would be that the transaction was—that Old Stone [Corporation] believed the transaction was beneficial to Old Stone Corporation. And my opinion would be that as a whole, the transaction was not beneficial to the Government overall.

Q. But . . . overall, *that's notwithstanding the fact that you testified a moment ago that the [Net Worth Maintenance Stipulation] did deliver a benefit to the Government?*

A. Well, that's an element of the transaction, deliver a benefit, that's ~~correct.~~

(Tr. at 1926-29 (emphasis added).)

Plaintiff notes that the holding company contributed a total of $118 million in stock and cash to FSLIC's insurance fund, "saved the government millions [of dollars] over [the cost of liquidation], paid millions more in insurance premiums to the FSLIC, surrendered its shareholder immunity . . . , [and] pledged [the holding company's] entire net worth for the benefit of the FSLIC." (Pl.'s Post-Trial Reply Mem. at 8.) Moreover, the holding company "devoted its managerial resources to the revitalization of the two failed thrifts." (*Id.*) An Office of Thrift Supervision memo to the district director dated March 1990 comments on the strength of management. (Pl.'s Ex. 369.) It states for example that the "association's management is considered competent [;] . . . [t]he management team was rated a 2 at the prior examination and the current examination does not seem to indicate a deterioration

in that situation." (*Id.* at OTS 01274.) The Government's response was that "*no* witness testified that FSLIC or the FHLBB saw the transaction as a 'huge benefit.'" (Def.'s Post-Trial Reply Br. at 5.)

The Government got what it bargained for, according to plaintiff—an infusion of capital into a failing bank. The Federal Circuit commented in *Hansen*, "there is no doubt that the merger was desirable from the FSLIC's point of view." 367 F.3d at 1316-17. "By assuming the liabilities [of the failing thrift], the Hansens allowed the FSLIC to avoid the high cost of bailing out another insolvent thrift." *Id.* at 1317. The Supreme Court observed in *Winstar* that goodwill treatment was "essential to supervisory merger transactions of the type at issue in [that] case."[38] 518 U.S. at 849. The Court cited a statement in the Congressional Record that goodwill was an "'inducement to the healthy savings and loans to merge with the sick ones.'" *Id.* at 850 n.6 (quoting 135 Cong. Rec. 12,061 (1989)).

E. Total Breach

The Government argued that plaintiff obtained part of what it bargained for and therefore the breach cannot be "total." *See, e.g., Hansen*, 367 F.3d at 1309 ("[R]estitution is 'available only if the breach gives rise to a claim for damages for total breach and not merely . . . for partial breach.'" (quoting *Restatement (Second) of Contracts* § 373 cmt. a (1981))); *see also Stone Forest*, 973 F.2d at 1550-51 (holding that materiality is determined by the totality of events and circumstances). The breach occurred five years after government performance of the contract, during which time "[Old Stone Bank] had the full benefit of goodwill and capital credits," defendant points out. (Def.'s Post-Trial Reply Br. at 3.)

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[38] These comments from the Supreme Court may be dicta because the Court did not review the materiality of the breach. *See Hansen*, 367 F.3d at 1310-11.

A total breach is one that "so substantially impairs the value of the contract to the injured party at the time of the breach that it is just in the circumstances to allow him to recover damages based on all his remaining rights to performance." *Restatement (Second) of Contracts* § 243(4) (1981). The appeals court describes this standard as follows: "[f]or all intents and purposes, this is a way of saying that the breach 'must be of a relatively high degree of importance.'" *Hansen*, 367 F.3d at 1311-12 (quoting George E. Palmer, *The Law of Restitution* § 4.5 (1978)). Thus, defendant's breach must substantially impair the value of the contract to plaintiff and it must be a relatively important breach. While substantial impairment is the standard for total breach, we assume that "substantial" is not measured by the number of provisions that defendant met. Rather it must be measured by the *value* of the benefits that the non-breaching party obtained before the breach. We did not find the status of a list of various forbearances and credits to be useful for this purpose.

Defendant pointed out in closing arguments that the court in *Hansen* did not change the law of restitution, but "reiterated . . . the restitution law that already was in existence. . . ." (Tr. at 2765.) "[W]hen [the Court of Appeals] . . . discuss[ed] the total breach issue . . . it refer[red] back to the [R]estatement . . . perhaps clarifying or edifying what the law already was." (*Id.*) The *Restatement* provides two illustrations to assist in distinguishing between total and partial breach for purposes of determining whether restitution is available:

> 1. *A* contracts to sell a tract of land to *B* for $100,000. After *B* has made a part payment of $20,000, *A* wrongfully refuses to transfer title. *B* can recover the $20,000 in restitution. The result is the same even if the market price of the land is only $70,000, so that performance would have been disadvantageous to *B*.
>
> 2. *A* contracts to build a house for *B* for $100,000, progress payments to be made monthly. After having been

> paid $40,000 for two months, *A* commits a breach that is not material by inadvertently using the wrong brand of sewer pipe. He has a claim for damages for partial breach but cannot recover the $40,000 that he paid.

See Restatement (Second) of Contracts § 373 cmt. a, illus. 1, 2 (1981).

The distinction between these illustrations is the materiality of the breach. In the second illustration, *B* did not receive the sewer pipe he wanted, but he has the substantial benefit of what he bargained for at the time of breach, i.e., a partially built house. *A*'s failure to use the correct brand of pipe does not go to the substance of the bargain; restitution is not available. In the first illustration, however, *A*'s refusal to transfer title goes to the heart of the bargain. Breach is total, and restitution is an available and appropriate remedy. The crucial distinction is materiality. In a complex contract case, some benefit may have been conferred on the non-breaching party, and any award of restitution can be offset by that value. *Westfed*, 55 Fed. Cl. at 561; *Restatement (Second) of Contracts* § 384 cmt. a (1981). The amount, however, must be ascertainable and proven. Defendant did not submit sufficient evidence for us to value benefits to plaintiff from the contract provisions that the Government did not breach. We do not have credible alternative numbers.

Defendant argues that plaintiff did not list the $103 million in stock as a cost in its reports to the Securities and Exchange Commission or to its shareholders. If this fact had legal significance, most courts focus on benefits to the breaching party rather than costs to the non-breaching party for purposes of restitution. *Glendale* suggests that the notion of costs to plaintiff in the restitution context should be de-emphasized. *See* 378 F.3d at 1313. Defendant promised capital credits and supervisory goodwill equal to roughly thirty-five percent of Old Stone's total regulatory capital when the contracts were signed. (Tr. at 1213-14.) The bank

lost at least $80 million of the regulatory capital promised to it as a result of the breach. (Tr. at 2361.)

Plaintiff's witnesses claimed during trial that the focus of the negotiations for acquisition of Rhode Island Federal was regulatory capital. (*See, e.g.*, Tr. at 148, 271, 733.) Regulatory capital was supremely important to plaintiff. Defendant questions the credibility of plaintiff's witnesses on this point, but we saw no reason to do so. Regulatory capital was certainly a material aspect of the Assistance Agreement for Old Stone Corporation.

F. Waiver

The non-breaching party may waive its right to restitution post-breach. The point of waiver in such circumstances is to prevent a non-breaching party from obtaining the benefits of a total breach and escaping his own responsibilities under the contract by terminating prematurely. *See Restatement (Second) of Contracts* § 373 cmt. a, illus. 1, 2 (1981). Plaintiff here continued to perform a part of the contract, the Net Worth Maintenance Stipulation, to its detriment. The holding company downstreamed $74.5 million under pressure from the regulators and lost it all. For plaintiff to waive its right to restitution by attempting to save the bank, and to save the Government money in the process, would be an ironic result.

The Federal Circuit described the *Restatement's* view of restitution in *Hansen:*

> The goal of restitution, to return the parties to their precise state before the contract, is incompatible with the situation of partial breach, *where the non-breaching party has, to some extent, benefitted from the transaction.* It is for this reason that section 384 of the Restatement makes recovery in restitution conditional on the return of any property that the parties have received pursuant to the agreement.

Hansen, 367 F.3d at 1309 n. 10 (emphasis added). Thus, continued performance arguably does not create waiver where

the non-breaching party did *not* obtain benefits from the contract after the breach. The Supreme Court noted in *Mobil Oil* that "the Government's waiver claim must come down to a claim that the companies received at least partial performance." 530 U.S. at 621-22. In other words, the non-breaching party must receive some benefit from the performance. *See Coast-to-Coast*, 60 Fed. Cl. at 711 (citing *Mobil Oil*, 530 U.S. at 622-23) ("[A] party does not waive its right to restitution simply by urging performance, but must actually receive some significant benefit from continuation of the contract."). Defendant did not show that plaintiff received benefit from its performance of the Net Worth Maintenance Stipulation.

G. Benefits to Plaintiff-Offset

Defendant argued that any award to plaintiff must be reduced by the benefits obtained by plaintiff from the contract. These include dividends that the bank upstreamed to the holding company after the merger. Defendant believes that it should also be given credit for any profits that the merged institution made after the Assistance Agreement was signed. "Because the purpose of restitution is to restore the plaintiff to its status quo ante, the award to the plaintiff must be reduced by the value of any benefits that it received from the defendant under the contract, so that only the actual, or *net*, loss is compensated." *Landmark*, 256 F.3d at 1373 (citing *Restatement (Second) of Contracts* § 384 cmt. a (1981) ("A party who seeks restitution of a benefit that he has conferred on the other party is expected to return what he has received from the other party."))(emphasis added).

The Federal Circuit observed in *Landmark* that "[t]he government's actions were simply not relevant to the dividends, which were generated as a result of Landmark's performance under the contract . . . ." 256 F.3d at 1373-74. "Thus, because the government was not responsible for the dividends paid by [the thrift] to Landmark, offset would not be proper." *Id.*

at 1374. The appeals court addressed this matter again in *Hansen.*

> *Landmark* makes clear that offset is proper only where the benefits at issue were received directly from the breaching party. Here, the dividend was not received from the government, nor pursuant to any requirement of the contract. The dividend from Hansens Savings cannot be fairly attributed to the government; accordingly, it should not detract from any recovery by the Hansens of their capital contribution.

Hansen, at 1315-16 (citing *Landmark*, 256 F.3d at 1374).

Defendant attempts to distinguish this case from *Landmark* and *Hansen* by arguing that the Assistance Agreement provided for plaintiff's dividends. This argument refers to the Dividend Stipulation. The Dividend Stimulation was a dividend *limitation*, however. It provided that the bank could not pay dividends exceeding a level that was somewhat higher than FSLIC policy at the time. The Government had nothing to do with the bank's dividends other than to limit them.

Defendant also argues that it is entitled to credit for contributions that it made to Rhode Island Federal ($9.95 million) and to Citizens Federal ($79 million) as part of those transactions. Both banks remained in a posture of negative net worth when plaintiff took them over, however.

H. Windfall

The breaching party has the burden of proving windfall. *American Capital*, 59 Fed. Cl. at 575 (citing *Restatement (Second) of Contracts* § 349 cmt. a (1981)). Plaintiff lost its business as a result of the contract. The holding company would have had no responsibility for supporting Old Stone Bank but for the Net Worth Maintenance Stipulation. It would not have been necessary to sell other profitable subsidiaries. The "pivotal question" according the Federal Cir-

cuit, "is whether an award of restitution would place the [plaintiff] in an overall better position than if the breach of contract had not occurred." *Hansen*, 367 F.3d at 1317. We heard no credible evidence that returning plaintiff's investment would place it in a better position than it would have been [in] had the Government not breached its contract.

The windfall issue is pivotal for another reason. Defendant argued that other economic pressures caused plaintiff's failure, or that the holding company and the bank would have failed irrespective of defendant's participation. If so, it seems that almost any award would be a windfall. Defendant did not offer evidence at trial sufficient for this court to make such findings, however.

I. Commingled Assets

The Citizen's transaction is not appropriate for restitution because the bank "was substantially altered while in the possession of [Old Stone Corporation]," according to defendant (Def.'s Post-Trial Br. at 33 n. 3.) Defendant explains:

> It was held as a separate subsidiary for one year and then merged in the operations of Old Stone Bank. It was sold in its entirety in May of 1990, four-and-one-half years after OSC had acquired it. During this time period, hundreds, if not thousands, of business decisions were made; assets were sold; assets were purchased; and numerous financial decisions were made.

(*Id.*) If we are to consider the possibility of restitution as a remedy, this rule cannot apply in the circumstances of this case. The requirement that property obtained according to a contract must be returned in the same condition is inappropriate for a transaction of this type, particularly when the property was lost as a result of the breach.

> We agree that the commingling of assets as a result of the . . . merger and the subsequent activities of Hansen

> Savings may make it difficult to "unwind" the transaction between the Hansens and the government for purposes of determining the appropriate amount, if any, that can be restored through restitution. We do not agree with the government, however, that this difficulty, on its own, prevents the Hansens from recovering any restitution. *It is the inherent nature of the merger transaction*, more than any alleged mismanagement after the merger, that makes it impossible for the Hansens to return "any interest in property that [they] ha[ve] received in exchange in substantially as good condition as when it was received by [them] . . . ." If mismanagement on their part is established, the Hansens may be accountable for any diminishment of the character or value of property that can be directly traced to their mismanagement. However, we do not think that the Hansens' restitution claim may not proceed based solely on the consequences of the merger transaction.

Hansen, 367 F.3d at 1318-19 (quoting *Restatement (Second) of Contracts* § 384 (1981)) (emphasis added). The Government did not attempt to trace any losses due to mismanagement or introduce any evidence of mismanagement. We heard no evidence of mismanagement during trial.

V. CONCLUSION

The Federal Savings and Loan Insurance Corporation told plaintiff to rely on its regulatory capital as though it were real. More importantly, plaintiff was to *use* the goodwill as though it were real. FSLIC said the bank should make loans with it; use it as leverage. Use it as a capital cushion. Include it in the capital ratios. Plaintiff paid $1.5 million per year in premiums to cover whatever risk resulted from this practice, including the possibility that Congress would change the rules. Net losses that defendant may incur from this judgment represent the risks that the Government contracted to insure.

The Federal Circuit has given trial courts some guidance in recent months concerning the proper means of analyzing the remaining *Winstar* cases. *See, e.g., Hansen*, 367 F.3d 1297; *Glendale*, 378 F.3d 1308. One issue in *Hansen* was whether a requirement that plaintiff transfer stock as part of the agreement were a true "condition" of the Assistance Agreement. 367 F.3d at 1317. The court held that it was in those circumstances. *Id.* Defendant made a similar argument here—that the provision requiring transfer of stock was not a term or condition of the contract, but a recital or a condition precedent.

We could assess damages in this case according to principles of reliance, restitution, or mitigation. These remedies are described in some detail in this Opinion to demonstrate their overlapping nature as applied to these facts. Contracts among the parties specifically required contributions that plaintiff wants returned. The breach was "total," and the other elements of restitution are present. Restitution normally does not cover post-breach expenses, but we cannot see how plaintiff's performance of the Net Worth Maintenance Stipulation created a waiver of its rights. If restitution were not available as a remedy, reliance would be. Reliance calls for the court to find that defendant violated the contract and caused foreseeable damages that can be calculated with reasonable precision. Plaintiff established all elements of reliance at trial.

The same is true of mitigation. Plaintiff supported the bank after the breach in an effort to save it and almost succeeded. Defendant argued that mitigation is not available because plaintiff "had" to downstream funds by contract under the Net Worth Maintenance Stipulation. Defendant has argued that issue both ways, depending on the remedy being discussed. We are mindful of the Federal Circuit's practical direction to trial judges in *Glendale* and elsewhere. *See, e.g., Glendale*, 378 F.3d 1308 (giving "additional guidance and support [to]

the trial courts . . . [so that] the remainder of the *Winstar* cases can be disposed of . . . based on the particular facts of the case, and without further dispute over the theory on which damages may be calculated").

Defendant's breach was the cause of plaintiff's damages. Obviously, the breach also was a "substantial factor" in causing plaintiff's damages. *See Energy Capital Corp. v. United States*, 47 Fed. Cl. 382 (2000), *aff'd in part, rev'd in part*, 302 F.3d 1314 (Fed. Cir. 2002). Plaintiff made an effort to operate according to the Assistance Agreement as well as to the requirements imposed after the breach. The bank would not have dropped below the two percent FDICIA[39] capital adequacy level absent the Government's breach; the bank would not have been seized. It is likely that the bank would have survived despite the breach given additional time for an effective and aggressive management team to negotiate its recovery plan. It follows that the breach and regulatory action related to the breach caused the bank's seizure.

The judgment is based on numbers that are not disputed. The factual issues addressed the extent to which plaintiff might not be entitled to the full amounts. For the most part, defendant did not offer alternative numbers into evidence or provide a means to calculate alleged offsets. The judgment below consists of damages that we verified by credible testimony and other evidence during trial:

1. Old Stone Corporation transferred all of its stock in the commercial bank, Old Stone Bank, to Rhode Island Federal pursuant to the Assistance Agreement, approved by the Federal Home Loan Bank Board as a Supervisory Conversion and Acquisition of Conversion Stock Agreement. The market value of the stock was $103.2 million, an amount not in dispute.

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[39] Federal Deposit Insurance Corporation Improvement Act of 1991, Pub.L. No. 102-242.

The Clerk will enter judgment for plaintiff in the amount of $103.2 million on that claim.

2. Old Stone Corporation contributed three percent of its capital at the time to Citizens Federal as part of a merger agreement similar to that used in Rhode Island Federal, a total of $14.8 million. The Clerk will enter judgment for plaintiff in the amount of $14.8 million on that claim.

3. Old Stone Corporation contributed $74.5 million to its subsidiary Old Stone Bank, FSB pursuant to the Net Worth Maintenance Stipulation. The Clerk will enter judgment for plaintiff in the amount of $74.5 million on that claim.

4. Old Stone Corporation claims that FSLIC adopted an FDIC requirement that it contribute $13 million to Rhode Island Federal before it was permitted to leave the FDIC insurance fund. Old Stone later abandoned that claim, which therefore is DISMISSED.

THEREFORE, the Clerk of Court will enter judgment for plaintiff Old Stone Corporation in the total amount of $192,500,000. No costs.

APPENDIX C

UNITED STATES COURT OF FEDERAL CLAIMS

No. 92-647 C

OLD STONE CORPORATION,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

Apr. 10, 2003

OPINION AND ORDER

HODGES, *Judge.*

The parties filed cross-motions for summary judgment on liability. The issues presented are (1) whether the Federal Home Loan Bank Board lacked authority to guarantee plaintiffs against risk of loss; and (2) whether assistance contracts remained binding on the Government though they terminated before passage and enactment of the Financial Institutions Reform and Recovery Act. We grant plaintiffs' motions for summary judgment.

I. AUTHORITY

The Federal Circuit has ruled that the FSLIC was authorized to enter assistance agreements. *See California Fed. Bank FSB v. United States*, 245 F.3d 1342 (Fed. Cir. 2001); *Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995) (en banc) (*Winstar II*). The FSLIC had general authority to make contracts "since its inception" pursuant to 12 U.S.C.

§ 1725(c)(3) (repealed). *Winstar II*, 64 F.3d at 1548. Defendant questions whether the FSLIC had authority to make a guaranty contract with a holding company that is not government-insured. It contends that neither the Federal Circuit nor the Supreme Court considered this issue according to applicable statutes.

Defendant questions whether the FHLBB was authorized to guarantee Old Stone that the Government would cover losses attributable to the holding company's purchase of a failing thrift. Courts have ruled that the FHLBB could guarantee against such losses pursuant to the authority of 12 U.S.C. § 1729(f)(2)(A) (repealed). *See, e.g., California Fed.*, 245 F.3d at 1347. Defendant argues that § 1729(f)(2)(A) applied only to "thrift-to-thrift" transactions, or to transactions involving two government-insured institutions. The terms of that section support defendant's interpretation.[1]

Section 1725(c)(3) granted the FSLIC more general authority "to make contracts." Defendant contends that § 1725(c)(3) did not apply to guaranty agreements either, because § 1729(f)(2) then would have had no purpose. Cases

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[1] Section 1729(f)(2)(A) provided:

> In order to facilitate a merger or consolidation *of an insured institution . . .with another insured institution* or the sale of assets of such insured institution and the assumption of such insured institution's liabilities by another insured institution, the Corporation is authorized, in its sole discretion and upon such terms and conditions as the Corporation may prescribe—
>
> (i) to purchase any such assets of assume any such liabilities:
>
> (ii) to make loans or contributions to, or deposits in, or purchase the securities of, such other insured institution . . . .
>
> (iii) to guarantee such other insured institution . . . against loss by reason of such other insured institution's merging or consolidating with or assuming the liabilities and purchasing the assets of such insured institution . . . 12 U.S.C. § 1729(f)(2)(A) (emphasis added).

in this court have so held. *See, e.g., Fifth Third Bank of W. Ohio v, United States*, 52 Fed. Cl. 829, 832 (2002). Similarly, it may be argued that the general language of § 1725(e) could not authorize the Old Stone transaction because § 1729(f)(2)(A) provided specific authority "to guarantee . . . insured institution[s] . . . against loss." Old Stone was not an "insured institution." 12 U.S.C. § 1729(f)(2)(A) (repealed). The rule that specific statute controls a general one without regard to priority of enactment is "well-established." *See, e.g., Jeffers v. United States*, 556 F.2d 986, 1003 (Ct. Cl. 1977) (citing *Bulova Watch Co. v. United States*, 365 U.S. 753, 758 (1961)).

Section 1729(f)(3) seems to settle the issue.[2] That section permitted the FSLIC to grant a holding company such as Old Stone the same financial assistance that it could have provided to an insured institution under subsection 1729(f)(2). The Government's response to that section is that the term "financial assistance" does not encompass a guarantee in these circumstances. We do not find that argument to be persuasive. *See generally Globe Sav. Bank F.S.B. v United States*, 55 Fed. Cl. 247 (2003) (discussing government's argument and the meaning of "financial assistance").

The Federal Circuit has not made the distinction between insured and non insured acquirors that defendant seeks. *See, e.g., California Fed.*, 245 F.3d at 1347 ("We have already answered the question of whether the FHLBB and the FSLIC have the authority to enter into contracts like these in the affirmative . . . ." (citing *Winstar II*, 64 F.3d at 1548).

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[2] "[T]he Corporation may provide any person acquiring control of, merging with, consolidating with or acquiring the assets of an insured institution . . . with such financial assistance as it could provide an insured institution under this subsection. 12 U.S.C. § 1729(f)(3). One court described this section as having given FHLBB *carte blanche* in an emergency thrift acquisition. *Globe*, 55 Fed. Cl. at 259.

II. TERMINATION

The Government's argument that terminated contracts were not enforceable is also a familiar one in this court. Defendant contends that the facts here are different from those of similar cases, which in any event it believes were wrongly decided. *See, e.g., California Fed. Bank v. United States*, 39 Fed. Cl. 753 (1997). Cases discussing termination clauses rely entirely on *Winstar II* according to the Government, and that decision addressed a supervisory action agreement with "completely different language." *See Winstar II*, 64 F.3d 1531.

Chief Judge Smith quoted the Plaintiffs' Coordinating Committee brief in *Cal Fed.*:

> [T]his exact issue was raised, and disposed of, in the Winstar test cases. The 'termination clauses' at issue employ similar or identical language. In fact, Section 9 of the [*Landmark* Assistance Agreement] was the agreement's termination clause, identical in all respects to those contained in the *Statesman*, *Winstar*, and *Suess* . . . assistance agreements.

California Fed., 39 Fed. Cl. at 762. Plaintiffs added, "there is no dispute that the government vigorously asserted this termination argument in the Winstar test cases, alleging that the validity of any promises that might have been made lapsed when the relevant [Assistance Agreement] terminated." *Id.*

Judge Smith noted that the Federal Circuit had "found the government's termination clause arguments 'unpersuasive,' stating that the expiration provisions applied only to the 'executory provisions set out in the [Supervisory Action Agreement] . . . .'" *Id.* (citing *Winstar II*, 64 F.3d at 1544, 1542). Furthermore, the court noted that the Supreme Court "could not have affirmed the existence of contracts with respect to amortization of goodwill or the counting of capital

credits toward net worth without rejecting Defendant's termination clause arguments." *Id.* at 763.

Defendant argues that the Federal Circuit's ruling limiting the termination provision to executory obligations is based on the language of Glendale Federal's termination agreement, which was different from the others. The Glendale agreement stated in part, "[t]his agreement shall terminate and the obligations of the FSLIC to make any payments hereunder shall cease upon the expiration of 10 years . . . ." The Government contends that this language caused the Federal Circuit to limit the termination provisions to executory provisions of the Assistance Agreement. *See Winstar II*, 64 F.3d at 1542 (expiration provision relates only to executory provisions of assistance agreement).

The language of the termination clause in this case "is structured differently, uses different language, and does not focus exclusively on FSLIC payment obligations," according to defendant. The termination clause in this case states, "[e]xcept as otherwise specifically provided in this Agreement, this Agreement shall terminate two years following the Effective Date or on such other date to which the parties or their successors agree in writing . . . ."[3] The Federal Circuit ruled that the termination clause in the Glendale agreement did not release the Government of all liability, even though the Glendale clause is more strongly worded than the termination clause here.[4] *See Winstar II*, 64 F.3d at 1542.

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[3] The termination language in assistance agreements between the Government and Landmark, Winstar, Statesman, and Seuss are essentially the same. The language of those agreements is "[e]xcept as otherwise specifically provided, this Agreement shall terminate five years following the Acquisition Date or on such other date to which the parties or their successors agree in writing . . . ."

[4] Plaintiffs observed in their brief that the Government can draft a release agreement "with unmistakable clarity" when it wants. This is an

Statesman Savings is similar in several respects to this case. *Statesman Sav. Holding Corp. v. United States*, 41 Fed. Cl. 1 (1998). The court addressed the argument that defendant raises in this case, that Chief Judge Smith based his ruling on the belief that the termination language of *Glendale* and of *Statesman* were the same.

> Admittedly, the above-quoted language [limiting termination to executory obligations] was taken from that portion of the Federal Circuit opinion addressing Glendale Federal Bank's breach claim. Chief Judge Smith applied the same language in his opinion addressing Common Issue No. 2 and noted that the termination clause language at issue in that opinion was identical to that involved in the cases of *Statesman*, *Winstar*, and *C. Robert Suess* . . . .

Id. at 8 (citing *Winstar II*, 64 F.3d at 1542).

The *Statesman* court explained that the *Winstar* line of cases implicated two distinct types of government promises—regulatory forbearances and executory promises. Termination of executory promises such as financial assistance, for example, would not necessarily affect plaintiffs' regulatory forbearances, including the right to amortize supervisory goodwill. *Statesman*, 41 Fed. Cl. at 7. The Federal Circuit ruled that the expiration language "in any event does not negate other obligations under the merger plan, including the

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agreement releasing FDIC from its obligations to Metropolitan Federal of North Dakota:

> The [bank], releasor, hereby releases and forever discharges the FDIC, the RTC, the OTS, the FSLIC, the FHLBB from any and all manner of action and action suits of every kind and character, direct, indirect, known and unknown, arising in whole or in part, out of or in connection with, the assistance agreements or the forbearance letters, or any other agreements, or documents related thereto.

specific time periods for amortization of goodwill." *Winstar II*, 64 F.3d at 1542.

The Government contends that such rulings in this court and in the Circuit apply to contracts that terminated according to the passage of time. The contracts in this case terminated by agreement of the parties. The agreement states, "this Agreement shall terminate two years following the Effective Date or on such other date to which the parties or their successors agree in writing . . . ."

This is the Federal Circuit's *Winstar* holding on the termination issue:

> [The Government] contends that the SAA expired by its terms in November 1991, prior to the alleged breach. We view the expiration provision as only relating to executory provisions set out in the SAA, which obligated the FSLIC to make certain payments to the merged thrift for a limited period of time. This provision of the SAA in any event does not negate other obligations under the merger plan, including the specific time periods for amortization of goodwill.

Winstar II, 64 F.3d at 1542. Neither the Federal Circuit's ruling nor the terms of the Agreement in this case supports the distinction that defendant attempts to make. The *Statesman* court evidently heard the same arguments because it addressed this issue as well:

> The court is also aware that both the Federal Circuit and Chief Judge Smith were considering the natural expiration of the assistance agreements, as opposed to the early termination that occurred in the case at bar. However, the decisional premise applied by both Chief Judge Smith and the Federal Circuit leads to an identical result in this case.

Statesman, 41 Fed. Cl. at 8.

CONCLUSION

Plaintiffs' motions for summary judgment on liability are GRANTED. Defendant's cross motion for summary judgment is DENIED. Counsel will contact the court by April 16 to schedule an early hearing on damages.

_____

Robert H. Hodges, Jr.
Judge

APPENDIX D

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

[Filed Sept. 21, 2006]

05-5059

OLD STONE CORPORATION,
Plaintiff-Appellee,

v.

UNITED STATES,
Defendant-Appellant.

ORDER

A combined petition for panel rehearing and for rehearing en banc having been filed by the Appellee, and a response thereto having been invited by the court and filed by the Appellant, and the petition for rehearing and response, having been referred to the panel that heard the appeal, and thereafter the petition for rehearing en banc and response having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for panel rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED. The mandate of the court will issue on September 28, 2006.

FOR THE COURT,

/s/ JAN HORBALY
Jan Horbaly
Clerk

Dated: 09/21/2006

cc: David M. Cohen
Melvin C. Garbow

OLD STONE CORP V US, 2005-5059
(CFC-92-CV-647)